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No. 86-1593

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1986

SHELL OIL COMPANY,

Appellant

vs.

DEPARTMENT OF REVENUE,
STATE OF FLORIDA

Appellee

On Appeal from the
Supreme Court of Florida

Motion of Appellee, Department of Revenue to Dismiss or Affirm

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MOTION TO DISMISS OR AFFIRM

Pursuant to Sup. Ct. R. 16, the Appellee, Department of Revenue of the State of Florida (Department), moves to dismiss this appeal on the grounds that it does not present a substantial federal question, the federal question as presented by Appellant (Shell) in its jurisdictional statement was not properly raised nor expressly passed on, and the judgment rests on an adequate non-federal basis or to affirm the decision of the Supreme Court of Florida.

STATUTORY PROVISIONS INVOLVED

This appeal raises the question of whether the inclusion of the income derived from the sale of oil within the various states of the United States in the apportionable tax base pursuant to §220.13, Florida Statutes, (Appendix 1), is repugnant to the limitation on a state's jurisdiction to levy taxes con-

tained in 43 USC §1333(a)(2)(A) (1970).

STATEMENT OF THE CASE

Shell's statement of the case contains utterances of purported fact which are not contained in or which cannot be adduced from the record of the case below. Hence, the Department presents its statement which is founded squarely on pertinent parts of the record below.

Shell is engaged in the oil and gas business and explores for and produces gas and refines and manufactures oil and gas into products which, in turn, are marketed by Shell. Shell markets its products, including chemicals, generally throughout the United States, its primary business in Florida being marketing. (Appendix 2).

Shell alleged that its Florida income taxes for the tax years 1972, 1973, 1974 and 1975 and Shell's oil and gas production business are involved in this

controversy. (Appendix 2). The Department admitted this allegation subject to the reservation that Shell's "production business" is inseparable from its "marketing business." (Appendix 3).

Shell alleged that its net income for the tax years in controversy was earned from its "production business" on the outer continental shelf (OCS). (Appendix 2). The Department admitted that Shell engaged in such production activities; however it denied that Shell's earnings of net income were derived from these activities alone, but arose from production activities coupled with marketing activities in the 50 states and the District of Columbia. (Appendix 3).

Shell alleged that the Department had included "OCS income" in the apportionable tax base but excluded OCS property and payroll from the denominators of two of the three fractions of the

apportionment formula and that the Department did not exclude "OCS sales" from the sales factor denominators. (Appendix 2). The Department admitted this allegation, but denied that Shell had signficant OCS sales. (Appendix 3). Thus, the factual issue of whether Shell had consummated by delivery any sales upon the OCS (other than possible de minimis amounts) was fairly joined in the pre-trial pleadings.[1]

The affidavit of the Department's auditor addressed how the Department corrected Shell's returns stating:

> In each of its Florida income tax returns for 1972, 1973, 1974 and 1975, Shell Oil exluded from its income, determined for federal income tax purposes, its wellhead fair market value of OCS oil, less related costs and expenses. Shell also excluded OCS property, OCS payroll and a wellhead fair market value of

[1] The Department notes that documentary evidence of Shell's having consummated (by delivery) any sales on the OCS, if any, was and remains exclusively within Shell's control.

> OCS oil from the denominators of the property, payroll and sales factors of the apportionment formula contained in §214.71, F.S., as modified by §220.15, F.S.
>
> ****
>
> During the audit of Shell Oil, I restored the fair market value, at the wellhead, of OCS oil to the sales factor for the apportionment formula. (Appendix 4).

The Department's final notice of its administrative decision asserted the reason such correction of Shell's returns was proper.

> At first blush it would appear that since the Department of Revenue is attempting to tax the income from Shell Oil Company's O.C.S. oil production that in deference to basic equity it should permit the inclusion of O.C.S. property and payroll values in the factoring denominators of the years being contested.
>
> Such a simplistic proposition would have to receive some sort of recognition if it squared with the facts which it does not since Florida is not taxing O.C.S. income but is taxing the ultimate sales of such production after it is piped, barged or boated to domestic refinery facilities.
>
> In short, such sales, based on the facts presently before us, are non-severable from total sales domestically...(Appendix 5).

Shell further alleged:

> The Department incorrectly and illegally calculated and assessed Florida income taxes payable by the Plaintiff in that:
> (a) OCS income was included by the Department in income subject to tax by Florida;
> (b) Alternatively, OCS income was included by the Department in income subject to tax by Florida without allowance of an offset to the extent that an offset would be produced by including OCS property and payroll in the respective pertinent fractions of the Apportionment Formulas;
> (c) Omitted.
> (d) The Department's actions were inherently arbitrary and capricious and produced an unreasonable result in violation of the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution, and in violation of the Interstate Commerce Clause in Article 1, Section 8 of the United States Constitution, in several respects including that Florida did not have nexus with the Plaintiff's OCS income supporting the taxation of that income...(Appendix 2).

The Department's response was as follows:

> Defendant responds to the allegations of Paragraph 13 as follows:
> (a) The allegations of Paragraph 13(a) are admitted, but the allegations that such action is incorrect or illegal is denied.
> (b) The allegations of Paragraph

13(b) are admitted, but the allegation that such action is incorrect or illegal is denied.
(c) Omitted.
(d) The allegations of Paragraph 13(d) are denied. (Appendix 3).

Shell, in its Amended Complaint, prayed for relief as to both computation of the income base and modification of the apportionment formula. However, prior to entry of the trial court's final judgment, Shell withdrew its second prayer for relief which sought modification of the apportionment formula and had required establishment of the controverted fact of OCS sales. (Appendix 6).

As part of its pre-trial preparation, the Department submitted an initial set of interrogatories to Shell. Interrogatory No. 29 and Shell's answers thereto are as follows:

29. (a) Does Plaintiff sell any of the products from its OCS production operations to purchasers not affiliated with Plaintiff in sales which take place outside the 50 states and District of Columbia?

Yes, the Plaintiff sells some of its oil and gas production to indpendent purchasers on the OCS, which is outside the 50 states and District of Columbia.

(b) Where are these sales made (i.e., at the wellhead, in foreign ports)?

They are made at or near the offshore wellhead.

(c) What percentage of Plaintiff's total OCS production (in barrels, cubic feet, etc.) was sold in the sales described in interrogatory 29 (a) for each year in controversy?

1972	1973	1974	1975
17.5%	21.4%	22.5%	19.2%

(Appendix 7).

Before the Department could seek documentary evidence to validate Shell's contentions of "OCS sales," Shell altered litigation strategy by filing its motion for Summary Judgment, which, stated:

1. The Department's treatment of Shell's income derived from its production business on the Outer Continental Shelf ("OCS") violates the Outer Continental Shelf Lands Act, 43 U.S.C. §1333(a)(2).

2. If Shell's income derived from its production business on the OCS

> should be included in Shell's net income for Florida income tax purposes, such income should be apportioned to Florida by the apportionment formula contained in Section 214.71, Florida Statutes, as modified by Section 220.15, Florida Statutes (the "Apportionment Formula"), or by the Apportionment Formula as further modified by including OCS property, payroll, and sales in denominators of the Apportionment Formula. (Appendix 8).

Critically, Shell petitioned for inclusion of OCS sales as well as OCS property and payroll in the apportionment formula in paragraph 2.

Subsequently, Shell amended its motion for summary judgment and withdrew paragraph 2 thereof. (Appendix 9). Thus, Shell not only waived OCS property and payroll, but also Shell waived OCS sales.

The Department also filed a motion for summary judgment stating therein:

> 1. The Department's treatment of Shell's income derived from its production business on the Outer Continental Shelf ("OCS") does not violate the Outer Continental Shelf Lands Act, 43 U.S.C. s. 1333(a)(2). (Appendix 10).

The final judgment entered by the trial court contains a concise statement of the case as presented to that court; to wit:

> Both Shell and the Department of Revenue of the State of Florida (the "Department") moved for summary judgment, and the court has previously entered two orders, both dated February 3, 1983, ruling on these motions. After deciding the motions for summary judgment, only one issue remained for determination, i.e., whether Shell's income derived from its production business on the Outer Continental Shelf ("OCS") should be apportioned by the apportionment formula contained in Section 214.71, Florida Statutes, as modified by Section 220.15, Florida Statutes (the "Apportionment Formula") or by the Apportionment Formula as further modified by including OCS property, payroll, and sales in the denominators of the Apportionment Formula. Although this issue was originally part of Shell's motion for summary judgment, Shell withdrew this issue prior to the summary judgment hearing. The court has denied the Department's motion for summary judgment on this issue. Shell has now filed a motion to amend to delete its prayer for relief relating to this withdrawn issue, and upon ruling on the motion to amend all issues will have been decided on summary judgment. Therefore, it is ORDERED AND ADJUDGED as follows:

1. Shell's Motion to Amend to delete its prayer for relief relating to the withdrawn issue is hereby granted.
2. The court adopts its orders dated February 3, 1983, on the motions for summary judgment filed by Shell and the Department as follows:

(a) Shell's Motion for Summary Judgment on the first issue raised by Shell, i.e., whether the treatment by the Department of Shell's income derived from its production business on the OCS violated the Outer Continental Lands Act, 43 U.S.C. s. 1333(a)(2) is denied, and the Department's Motion for Summary Judgment on this issue is granted. (Shell Appendix 3).

Thus, Shell overtly and constructively withdrew both its controverted claim of having consummated by delivery any sales whatsoever upon the OCS and withdrew its allegation that the apportionment method applied by Florida was constitutionally flawed. Shell did not pursue alternatives available at the trial court level but chose to pursue its appeal on the sole issue recognized and resolved by the trial court.

In its decision, the First District

Court of Appeals of Florida stated:

> ...the income in Shell's case was realized totally from sales of oil in the various states of the United States.

Shell Oil Co. v. Dept. of Revenue, 461 So.2d 959, 961 (Fla. App. 1 Dist. 1984). Shell did not thereafter request a rehearing in the District Court of Appeals for the First District of Florida to clarify any facts which the court may have overlooked or misapprehended.

In its initial brief to the Florida Supreme Court, Shell reaffirmed its withdrawal at the trial court of any potential for constitutional challenge to the method of apportionment.

> To avoid confusion on the important "exclusion" (from income) issue, Shell elects not to argue the apportionment issue before the Court. (Appendix 11).

Shell thereby also constructively reaffirmed its waiver of any contention of having consummated sales on the OCS.

The following excerpts from the decision of the Supreme Court of Florida are expositive of the statement of the case:

> The Florida Department of Revenue (DOR) disallowed Shell's exclusion of certain OCS production income from its Florida tax base for fiscal years 1972-75.
>
> ****
>
> Further, DOR concedes that any revenues which Shell derives from actual sales consummated on the OCS oil platforms are beyond the reach of Florida's taxing power as limited by section 1333(a)(2). Accordingly, the dispute concerns only the income derived from sales of OCS oil actually made within the boundaries of the fifty states.
>
> DOR contends that because Shell sold the oil within the boundaries of the fifty states, and not on the OCS, the taxable event occurred within the reach of Florida's tax law. On the other hand, Shell contends that the time and location of the actual sale are irrelevant because no sale of OCS production can ever be subject to state taxation. Shell claims that section 1333(a)(3) of the Outer Continental Shelf Lands Act supports this contention.
>
> ****
>
> We find that Shell's reliance on section 1333(a)(3) is misplaced. Although section 1333(a)(3) prevents states from claiming an interest in or jurisdiction over the revenues

> derived from OCS natural resources, the language of this subsection when read in conjunction with the rest of section 1333(a) simply constitutes a limitation of state authority over the OCS area and does not seem intended to address income derived outside the OCS.
>
> ****
>
> ...In the instant case Shell realized the income within the fifty states and both parties agree that Florida can generally levy an apportioned tax on income derived within any of the fifty states. Thus Shell has offered no relevant authority for its claim that OCS production sold in the states should be an exception to the norm. As the district court pointed out, taking Shell's argument to its logical conclusion, no state could impose any kind of tax on any final product which eventually might be derived from OCS production. We join the district court in finding that Congress never intended such a sweeping result when it passed the Outer Continental Shelf Lands Act....

Shell Oil Co. v. Dept. of Revenue, 496 So.2d 789, 790, 791 (Fla. 1986).

In its motion for rehearing to the Supreme Court of Florida, Shell sought to resurrect its twice waived challenge to the apportionment formula. (Appendix 12). The Department's response specifically asserted Shell's lack of standing.

(Appendix 13).

Shell also filed a motion for order compelling compliance with court decision, attaching several documents thereto. (Appendix 14). By this motion, Shell attempted to resurrect the controverted question of the existence of actual sales consummated upon the OCS which it had abandoned in pursuing its litigation strategy attendant to and flowing from the summary judgment proceedings. The Department moved to strike. (Appendix 15). Shell responded. (Appendix 16).

Shell's motion for rehearing was denied and the Department's motion to strike was granted. (Shell Appendix 4).

In its jurisdictional statement, Shell paraphrases statements made by the Supreme Court of Florida.

> ...In the case of natural gas, all transfers were made by sale to non-affiliated, independent pipeline

> companies which rent space and take delivery of the gas on the platform....(page 7).

The trial court record does not establish that Shell delivered natural gas to pipelines of third parties on the OCS. Doubtless, references to such sales are gratuitous utterances in response to Shell's argument of its waived inchoate factual issue. These references are clearly excluded from the certified question the Supreme Court of Florida stated it was addressing.

> Whether the State of Florida is prohibited by U.S.C. s. 1333(a)(2)(A) [sic] from imposing a tax upon income derived from the sale in the United States of oil extracted from the outer Continental Shelf?[2]

Shell Oil Co. v. Dept. of Revenue, 496 So.2d 789, 789 (Fla. 1986).

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[2] Section 7701(a)(9) of the Internal Revenue Code of 1986 provides: United States--the term "United States" when used in a geographic sense includes only the States and the District of Columbia.

Shell's jurisdictional statement enlarged the question presented beyond that addressed by the Florida courts to include hypothetical elements.

The Department has also modified the question. However, the Department's version assures clarity and rests wholly within the parameters of the record below.

REASONS FOR DISMISSAL OR AFFIRMATION

The Department asserts that the Supreme Court of Florida utilized the appropriate burden of proof to determine that the income Shell derived from oil sold in the various states was includable in Florida's tax base. The decision conforms with concepts of income under generally accepted accounting principles (GAAP) and federal concepts of realization. The decision relies on and conforms to this Court's decisions regarding the ability of the states to tax income given

specific geographic situs. And finally, the decision is not repugnant to any federal statute nor the U.S. Constitution. Thus, there is no prohibition against Florida's inclusion of the income in its apportionable tax base, and hence, this case presents no substantial federal question.

Shell below has waived the apportionment argument, and consequently any fact of sales on the OCS; therefore, the only remaining question is whether income derived from sales in the various states is includable in Florida's apportionable tax base.

As to Shell's lack of standing with regard to a possible constitutional issue steming from apportionment, the Department restates the extract from Shell's Initial Brief to the Supreme Court of Florida in which it reaffirmed its waiver below.

> To avoid confusion on the important "exclusion" (from income) issue, Shell elects not to argue the apportionment issue before the Court. (e.s.) (Appendix 11).

Any question as to the possible latent constitutional infirmity of the state's chosen apportionment method is waived where the taxpayer voluntarily elects to limit its attack by addressing solely the tax base. Mobil Oil Corp. v. Commissioners of Taxes of Vermont, 445 U.S. 425 (1980).

When claiming an erosion of the initial tax base, the burden rests with the taxpayer to point to an applicable statute and demonstrate he comes within its terms. New Colonial Ice Co. v Helvering, 292 U.S. 435 (1934); and Tax Court Rule 142. The burden of proof is intertwined with the presumption that the tax administrator's determination of a deficiency in tax is prima facie correct. Welch v. Helvering, 290 U.S.

111 (1933).

Mere internal transfers of crude oil between Shell's production division and Shell's marketing division are non-events for income tax accounting purposes, regardless of assignment of artificial "prices" to such transfers for internal purposes. Shell is a vertically integrated petroleum company and as such its production, refining and marketing divisions are unitary. The respective contributions of the production division, refining division, and the marketing division which generate the entire net income are inexorably intertwined and it is constitutionally permissible to require aggregation of the income of all divisions in a single apportionable tax base. Exxon Corporation v. Wisconsin Department of Revenue, 447 US 207 (1980).

Under generally accepted accounting principles, income is normally not con-

sidered as existing before it is fully realized.

> Realization. The process of converting noncash resources and rights into money or, more precisely, the sale of an asset for cash or claims to cash....
>
> ...the earnings process occurs throughout the various stages of production, sales and final delivery of the product. However, the difficulty in measuring the precise rate at which this earnings process is taking place has lead accountants to conclude that income should normally be recognized only when it is fully realized. Realization generally implies that the enterprise producing the item has completed all of its obligations relating to the product and that collection of the resulting receivable is assured beyond reasonable doubt.

Delaney, Adler, Epstein, and Foran, GAAP-Interpretation and Application, pp. 44, 45 (1985 ed.)

The identical realization concept is contained in federal income tax law.

> Section 61(a) incorporates a realization requirement in the definition of gross income. The section refers to "income from whatever source derived," "Gross income derived from

business," and "Gains derived from dealings in property."
To be taxed, gains must be realized, that is, sufficiently fixed and definite to be treated as gross income. Realization generally connotes a sale of an asset for cash or its exchange for other property. As a result of the realization requirement, the income tax taxes transactions.

****

In Helvering v. Horst,[3] decided shortly after Helvering v. Brunn, the Supreme Court amplified its definition of the realization requirement as the taxable event that occurs "when the last step is taken by which [the taxpayer] obtains the fruition of economic gain which has already accrued to him." The Court also explicity characterized the realization requirement as one "founded on administrative convenience."

Solomon, Gross Income-Conceptual Aspects, p. A-30, 31 (1986).

Thus, no income is realized prior to the consummation of an actual sale. Shell's concept that the act of extraction of oil creates "production income" does not exist either under GAAP or under

3 311 U.S. 112 (1940)

the IRC.

The Supreme Court of Florida stated as follows:

> In the case at bar, this realization occurred at the time of sale. Clearly, no realization of income occurred at the wellhead, despite Shell's assignment of an artifical wellhead price to the oil, because Shell received no actual economic gain from any "sale, exchange, or other disposition of property" at that point. §220.02(4)(a). Rather, realization occurred at the time Shell sold the oil in the states because only at that time did Shell derive any actual economic gain.

Shell Oil Co. v. Dept. of Revenue, 496, So.2d 789, 791 (Fla. 1986).

"Production income" is "phantom income" under these concepts. Shell construes the OCS Lands Act to authorize such "phantom income" by inference. Had Congress intended such a radical departure from established income tax and accounting concepts, it would have so provided clearly and unequivocally.

Under federal income tax concepts,

jurisdication is based on "residence" of domestic entities and is exercised world-wide with a credit allowed for foreign taxes. However, the case of a foreign entity provides insight as to assigning geographic situs to income for tax purposes. A foreign entity is subject to federal jurisdiction based upon situs of the business activity of consummating a sale.

> (4) Under 199(a)(6) and (e) of the 1939 Code, a nonresident alien engaged in business here derives income from the sale of personal property in the country in which [the goods are] sold.

United States v. Balanowski, 236 F.2d 298, 304 (2d Cir 1956). Where production occurs without a state's geographic limits and no sale has occurred, the costs of production are merely assigned as the value of property held in inventory. This is true of motor vehicles produced in Japan and Germany, of

diamonds extracted in Africa and of oil extracted in the Middle East or within a given state.

In its jurisdictional statement, Shell states that a "sales equivalent" is used "...for computing income from Shelf property under sections 613 and 613A of the IRC where there have been no sales to independent third parties...." To preclude possible misapprehension, the Department notes that for both federal and Florida income tax purposes, Shell, as a general corporation, computes "taxable income" pursuant to section 63(a) of the IRC.

The value of extracted petroleum products measured at the wellhead based upon artificial "prices" is used as a lesser included mathematical convention specifically for the limited purpose of determining the allowable deduction in respect of depletion as authorized pursu-

ant to section 613 and 613A of the IRC, and is not used to determine gross income.

Next, Shell's jurisdictional statement references the fact that Senator Long of Louisana, arguing in support of a subsequently rejected proposed amendment to the Outer Continental Shelf Lands Act objected to the intended result that "....the employers...are subject neither to the State's severance tax, property tax nor the tax on corporate profits." To place this quotation in context, the rejected amendment was intended to prescribe state jurisdiction coterminus with that of the federal government. The activities, events and transactions contemplated by Senator Long were those expected to occur on the OCS, and not to transactions or events which subsequently occur clearly within the recognized geographic limits (3-mile) of a given state.

Finally, Shell relies heavily upon the Court's decision in Maryland v. Louisiana, 451 U.S. 725 (1981) to demonstrate that Florida is laying its income tax upon activities which occur on the OCS. Shell's view of the rationale of that decision rests on analogy to a severance tax and not to an income tax. The respective thresholds for imposition of each differ critically. Further, the Supreme Court of Florida stated at footnote 2:

> If this were not so, we would be at a loss to understand why the United States Supreme Court, in Maryland v. Louisiana, 451 U.S. 725, 101 S.Ct. 2114, 68 L.Ed.2d 576 (1981), tested the validity of Louisiana's "first use" tax by examining its effect on inter-state commerce rather than by scrutinizing the viability of taxing gas derived from the outer continental shelf.

Shell Oil Co. v. Dept. of Revenue, 496 So.2d 789, 790 (Fla. 1986).

In the case sub judice, Florida is laying its income tax upon its apportioned share

of income derived by Shell from sales consummated within the various states of the United States.

CONCLUSION

The sole question before this Court as presented by the Department herein was properly resolved by the Supreme Court of Florida. Florida's jurisdiction to tax as validated by that court is not repugnant to 43 USC §1333(a)(2)(A) (1970) nor any constitutional provision and is wholly in harmony with standing decisions of this Court. Shell's self-deluding illusion of "production income" is and remains non-existent "phantom income." The income realized from actual sales of oil consummated within the various states of the United States is properly includable in Florida's apportionable tax base. Therefore, this case presents no substantial federal question. Accordingly, the Department respectfully urges

this Court to grant its motion to dismiss Shell's appeal or to affirm the decision of the Supreme Court of Florida.

Respectfully submitted,

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A P P E N D I X

Appendix 1

220.13 **Adjusted federal income defined.-**

(1) "Adjusted federal income" shall mean an amount equal to the taxpayer's taxable income as defined in subsection (2), or said taxable income of more than one taxpayer as provided in §220.131, for the taxable year, adjusted as follows:

(a) OMITTED

(b) Subtractions.-

1. In computing the net operating loss deduction allowable for federal income tax purposes under section 172 of the Internal Revenue Code for the taxable year, the net capital loss allowable for federal income tax purposes under section 1212 of the Internal Revenue Code for the taxable year, the excess charitable contribution deduction allowable for federal income tax purposes under section 170 (d)(2) of the Internal Revenue Code for

the taxable year, and the excess contributions deductions allowable for federal income tax purposes under section 404 of the Internal Revenue Code for the taxable year, there shall be subtracted from taxable income, in order to arrive at adjusted federal income, such amounts as reflect the following limitations:

a. No deduction shall be allowed for net operating losses, net capital losses, and excess contribution deductions under sections 170(d)(2) and 404 of the Internal Revenue Code which are carried forward from taxable years ending prior to January 1, 1972; and

b. The net operating loss, net capital loss, and excess contributions deductions under sections 170(d)(2) and 404 of the Internal Revenue Code, respectively, allowable for any taxable year beginning before and ending after January 1, 1972 shall be limited to an amount

which bears the same ratic to the taxpayer's net operating loss, net capital loss, and excess contributions deductions under sections 170(d)(2) and 404 of the Internal Revenue Code, respectively, for the entire taxable year as the number of days in such year after December 31, 1971 bears to the total number of days in such year, unless the taxpayer elects to account separately for income under subsection 220.12(3) of this code, in which case the net operating loss, net capital loss, and excess contributions deductions under sections 170(d)(2) and 404 of the Internal Revenue Code, respectively, allowable for such year shall be determined on the basis of the items actually earned, received, paid, incurred, or accrued after December 31, 1971; and

c. A net operating loss and a capital loss shall never be carried back

as a deduction to a prior taxable year, but all deductions attributable to such losses shall be deemed net operating loss carryovers and capital loss carryovers, respectively, and treated in the same manner, to the same extent, and for the same time periods as are prescribed for such carryovers in section 172 and section 1212, respectively, of the Internal Revenue Code.

2. There shall be subtracted from such taxable income any amount included therein:

a. Under section 78 or section 951 of the Internal Revenue Code;

b. Which was derived from sales outside the United States, and from sources outside the United States as interest, as a royalty, or as compensation for technical or other services; and

c. Which was received as a dividend

from a corporation which neither transacts any substantial portion of its business in the United States nor regularly maintains any substantial portion of its assets within the United States.

However, as to any amount subtracted under this subparagraph, there shall be added to such taxable income all expenses deducted on the taxpayer's return for the taxable year which are attributable, directly or indirectly, to such subtracted amount.

(c) OMITTED

(2) For purposes of this section, a taxpayer's taxable income for the taxable year shall mean taxable income as defined in section 63 of the Internal Revenue Code and properly reportable for federal income tax purposes for the taxable year, but subject to the limitations set forth in paragraph (1)(b) with respect to the deductions provided by sections 172

(relating to net operating losses), 170(d)(2) (relating to excesscharitable contributions), 404(a)(1)(D) (relating to excess pension trust contributions), 404(a)(3)(A) and (B) (to the extent relating to excess stock bonus and profit-sharing trust contributions), 404(d) (relating to excess contributions under the 1939 code) and 1212 (relating to capital losses) of the Internal Revenue Code, except that, subject to the same limitations:

(a) "Taxable income," in the case of a life insurance company subject to the tax imposed by section 802 of the Internal Revenue Code, shall mean life insurance company taxable income; however, the amount of said income determined under paragraph 802(b)(3) of the Internal Revenue Code which shall be taken into account for purposes of this code shall never exceed, cumulatively,

the excess of amounts determined under said paragraph as of the close of the taxpayer's taxable year over the amount determined under said paragraph as of December 31, 1971;

(b) "Taxable income," in the case of a mutual insurance company subject to the tax imposed by section 821(a) or (c) of the Internal Revenue Code, shall mean mutual insurance company taxable income or taxable investment income, as the case may be;

(c) "Taxable income," in the case of an insurance company subject to the tax imposed by section 831(a) of the Internal Revenue Code, shall mean insurance company taxable income;

(d) "Taxable income," in the case of a regulated investment company subject to the tax imposed by section 852 of the Internal Revenue Code, shall mean investment company taxable income;

(e) "Taxable income," in the case of a real estate investment trust subject to the tax imposed by section 857 of the Internal Revenue Code, shall mean real estate investment trust taxable income;

(f) "Taxable income," in the case of a corporation which is a member of an affiliated group of corporations filing a consolidated income tax return for the taxable year for federal income tax purposes, shall mean taxable income of such corporation for federal income tax purposes as if such corporation had filed a separate federal income tax return for the taxable year and each preceding taxable year for which it was a member of an affiliated group, unless a consolidated return for the taxapyer and others is required or elected under §220.131;

(g) "Taxable income," in the case of a cooperative corporation or association, shall mean the taxable income of such

organization determined in accordance with the provisions of section 1381 through 1398 of the Internal Revenue Code;

(h) "Taxable income," in the case of an organization which is exempt from the federal income tax by reason of section 501(a) of the Internal Revenue Code, shall mean its unrelated business taxable income as determined under Section 512 of the Internal Revenue Code; and

(i) "Taxable income," in the case of a corporation for which there is in effect for the taxable year an election under section 1372 of the Internal Revenue Code, shall mean the amount of income subject to tax at the corporate income tax level under paragraph 1372(b)(1) of the Internal Revenue Code for each taxable year.

Appendix 2

IN THE CIRCUIT COURT FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff,

vs. Case No. 80-987

DEPARTMENT OF REVENUE
OF THE STATE OF FLORIDA,

Defendant. /

AMENDED COMPLAINT

Plaintiff Shell Oil Company sues defendant Department of Revenue of the State of Florida (the "Department") and alleges:

General Allegations

1. This is an action challenging a corporate income tax assessment by the Department, and this Court has jurisdiction under Article V, Section 20, Florida Constitution, and Sections 26.012, and 86.011 et. seq., Florida Statutes.

2. Plaintiff is a Delaware corporation with its principal place of business

in Houston, Texas, authorized to do business in Florida. Plaintiff is engaged generally in an oil and gas business and explores for and produces oil and gas and refines and manufactures oil and gas into products which in turn are marketed by Plaintiff.

3. Plaintiff produces oil and gas in more than a dozen states of the United States and on the Outer Continental Shelf of the United States ("OCS"). Plaintiff refines petroleum products in eight refineries in six states of the United States and in chemical plants in some of those six states and in other states.

4. Plaintiff markets its products, including chemicals, generally throughout the United States. Plaintiff's primary business in Florida is marketing.

5. It is the Plaintiff's Florida income taxes for 1972, 1973, 1974, and 1975 ("the Years in Controversy") and the Plaintiff's oil and gas production

business ("Production Business") that are involved in the controversy associated with this action.

As to the "OCS" Issue

6. Part of the Plaintiff's net income for the Years in Controversy was earned by the Plaintiff from its Production Business on the OCS.

7. In its Florida income tax returns for the Years in Controversy, the Plaintiff excluded income earned from its Production Business on the OCS from income apportionable to Florida, and, consistently therewith, excluded OCS real and tangible personal property from denominators of property fractions, OCS payroll from denominators of payroll fractions, and OCS sales from denominators of sales fractions of the apportionment formula contained in Section 214.71, Florida Statutes (the "Apportionment Formula").

8. After an audit of Plaintiff's returns for the Years in Controversy, the Department proposed to make additional assessments of Florida income taxes for the Years in Controversy by including OCS income in the tax base, and OCS property, payroll and sales in the denominators of respective fractions of the Apportionment Formula.

9. After a conference, instead of accepting the Plaintiff's position that OCS income, property, payroll and sales had to be excluded from the calculation of Florida taxable income, the Department enlarged the original audit as to this issue by including (as on the original audit) OCS income in apportionable income, but (different from the original audit) excluding OCS property and payroll from denominators of two of the three fractions of the Apportionment Formula. The Department did not exclude OCS sales from the sales

factor denominators.

10. The Department's enlargement of the initial audit was communicated to Plaintiff in a letter dated August 11, 1977.

11. The Plaintiff duly protested the Department's proposed assessments by a letter dated October 3, 1977, and asked the Department to reconsider its position.

12. The Department communicated its response (on this and other issues) by a letter dated February 4, 1980, which is taken by the Plaintiff to be the Department's final decision on the subject. The Plaintiff has elected judicial review by filing this action.

13. The Department incorrectly and illegally calculated and assessed Florida income taxes payable by the Plaintiff in that:

(a) OCS income was included by the

Department in income subject to tax by Florida;

(b) Alternatively, OCS income was included by the Department in income subject to tax by Florida without allowance of an offset to the extent that an offset would be produced by including OCS property and payroll in the respective pertinent fractions of the Apportionment Formula;

(c) The Department's apportionment method did not fairly represent the extent of the Plaintiff's tax base attributable to Florida, and the Plaintiff therefore petitions for relief under Section 214.73, Florida Statutes; and

(d) The Department's actions were inherently arbitrary and capricious and produced an unreasonable result in violation of the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution, and in violation of the

Interstate Commerce Clause in Article 1, Section 8 of the United States Constitution, in several respects including that Florida did not have nexus with the Plaintiff's OCS income supporting the taxation of that income, that the Department's apportionment was not internally consistent and did not constitute fair apportionment, that the Plaintiff would be discriminated against by the Department by this method of apportionment because other taxpayers are not taxed without full representation of property and payroll in the formula, and that Florida has not given benefit to the Plaintiff's OCS activities supporting the Department's tax on the Plaintiff's OCS income.

14. The Plaintiff believes and submits that Plaintiff and the Department can agree as to how tax may be correctly computed, once Florida and U.S. law are

construed in this case as to the principles to be followed.

As to the "IDC" Issue

15. In connection with its Production Business, the Plaintiff drills oil and gas wells from which a large portion of its income is derived.

16. In computing Federal and Florida taxable income, portions of the costs of drilling and equipping oil and gas wells must be capitalized, and portions are subject to being expensed. The parts subject to expense treatment are called "intangible drilling and development costs" ("IDCs") in the Internal Revenue Code and Regulations. IDCs are creatures of Federal tax law.

17. IDCs are items of such as the labor, fuel and hauling that go into the drilling of oil and gas wells. A producing oil and gas well has a cost, in ordinary usage, that includes the entire

cash outlay, without regard to its being partly capitalized and partly expensed for purposes of computing Federal taxable income.

18. The Plaintiff capitalizes (and depreciates) all of the costs of its producing oil and gas wells for financial (or "book") purposes in order to compute net income. The Plaintiff capitalizes (and depreciates) tangibles and expenses IDCs in order to compute taxable income for Federal income tax purposes, and in order to compute the tax base for Florida income tax purposes.

19. The Plaintiff filed its Florida income tax returns for the Years in Controversy by including all of the costs of its onshore producing oil and gas wells, including the IDCs, in the property fraction of the Apportionment Formula.

20. The Department audited and

excluded the Plaintiff's IDCs from the property fraction of the Apportionment Formula.

21. The Department thereby excluded a portion of the costs of the Plaintiff°s (all outstate) income producing assets from denominators of property fractions, and thereby augmented Florida°s apportionment of the Plaintiff°s taxable income for taxation by Florida.

22. The Department incorrectly and illegally calculated and assessed Florida income taxes payable by the Plaintiff in that:

(a) The Department°s treatment violated the provisions of Section 214.71(1)(a), Florida Statutes, which values owned real and tangible personal property at its "original cost" for Apportionment Formula purposes;

(b) Alternatively, the Department°s apportionment method did not fairly

represent the extent of the Plaintiff's tax base attributable to Florida, and the Plaintiff therefore petitions for relief under Section 214.73, Florida Statutes; and

(c) The Department's actions were inherently arbitrary and capricious and produced an unreasonable result in violation of the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution, and in violation of the Interstate Commerce Clause in Article 1, Section 8 of the United States Constitution, in that, as applied, the apportionment was internally inconsistent and fair apportionment was not provided; and the Plaintiff was discriminated against in comparison with other taxpayers having their entire capital costs of includible properties represented in property fractions.

23. The Plaintiff believes and submits that Plaintiff and the Department can agree as to how tax may be correctly computed, once Florida and U.S. law are construed in this case as to the principles to be followed.

Mechanical Errors

24. The Department's audit schedules for 1974 reflect a Florida property factor of the Apportionment Formula of .003601, which is a mathematical error. Based on the Department's calculations contained in other parts of its audit schedules, the Florida property factor should be .003404.

25. The corrections of the mathematical error in the property factor results in an Apportionment Formula of .018686, rather than .018881 as calculated in the audit schedules.

26. The correction of the Apportionment Formula results in a

"Corrected Income Tax Liability" of $521.708 rather than $527,212 as shown on the Department's audit schedules.

Statute of Limitations

27. On about September 20, 1973, the Plaintiff filed its Florida income tax return for 1972, pursuant to a timely requested extension date of October 1, 1973.

28. Section 214.09, Florida Statutes, requires that the Department issue a notice of deficiency not later than three years after the date on which the return is filed, and unless such notice is issued within the required time, no deficiency may be assessed or collected with respect to that taxable year. The Plaintiff waived the expiration of this statute of limitations for the taxable year 1972 until December 31, 1976.

29. On December 14, 1976, the

Department sent to the Plaintiff a Notice of Proposed Deficiency for the Years in Controversy.

30. On August 11, 1977, after the period of limitations for the taxable year 1972 had run, the Department sent to the Plaintiff a revised Notice of Proposed Deficiency in which the December 14, 1976 proposed deficiency was enlarged for all the Years in Controversy (including 1972). Therefore, all or a portion of the proposed deficiency is barred by the applicable statute of limitations.

WHEREFORE, the Plaintiff prays that the Court will declare that:

I. The Department is required to compute the Plaintiff's income taxable by Florida by excluding the Plaintiff's taxable income attributable to the OCS, and, correspondingly, by excluding OCS property, payroll and sales from

denominators of the fractions of the Apportionment Formula.

II. Alternatively, as to I, the Department is required to compute the fractions of the Apportionment Formula by including OCS property, payroll and sales in denominators of the respective fractions.

III. The Department is required to compute the property fractions of the Apportionment Formula by including IDCs therein.

IV. The Department is required to correct mechanical or mathematical errors in its computation of Florida income taxes payable by Plaintiff.

V. The assessment by the Department of all or a portion of the Florida income taxes for the Plaintiff for 1972 is barred by the applicable statute of limitations.

VI. Such other and further relief as the Court may deem necessary.

Hume F. Coleman,
Stanley W. Rosenkranz and
Robert B. Glenn, Jr., of
HOLLAND & KNIGHT
Post Office 1288
Tampa, Florida 33601
(813)223-1621

Attorney's for Plaintiff

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U.S. Mail to E. Wilson Crump, II, Assistant Attorney General and David K. Miller, Assistant Attorney General, Department of Legal Affairs, The Capitol, 1104, Tallahassee, Florida 32301, attorneys for Defendant, this 23rd day of July, 1980.

Stanley W. Rosenkranz

Appendix 3

IN THE CIRCUIT COURT OF THE
SECOND JUDICIAL CIRCUIT, IN
AND FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff,

vs. CASE NO. 80-987

DEPARTMENT OF REVENUE
STATE OF FLORIDA

Defendant, /

ANSWER AND DEFENSES TO AMENDED COMPLAINT

Defendant, Department of Revenue of the State of Florida, answers the Complaint as follows:

1. The allegations of Paragraph 1 are admitted.

2. The allegations of Paragraph 2 are admitted.

3. The allegations of Paragraph 3 are admitted.

4. The allegations of the first sentence of Paragraph 4 are admitted. Defendant lacks knowledge of the allega-

tions of the second sentence of Paragraph 4 sufficient to admit or deny them, and therefore denies them.

5. The allegations of Paragraph 5 are admitted, subject to the reservation that Plaintiff's "production business" is inseparable from its "marketing business."

6. Defendant admits that Plaintiff engaged in production activities on the OCS during the years in controversy. Defendant denies that Plaintiff's earnings of net income were derived from these production activities alone, but from the production activities coupled with marketing activities in the 50 states and the District of Columbia. All subsequent responses to Plaintiff's allegations concerning income derived from OCS production activities are subject to this reservation.

7. The allegations of Paragraph 7

are admitted.

8. The allegations of Paragraph 8 are admitted.

9. The allegations of Paragraph 9 are admitted, but Defendant denies that Plaintiff had substantial OCS sales.

10. The allegations of Paragraph 10 are admitted. The Defendant communicated its revised audit position to Plaintiff prior to the date of the referenced letter, however.

11. The allegations of Paragraph 11 are admitted.

12. The allegations of Paragraph 12 are admitted.

13. Defendant responds to the allegations of Paragraph 13 as follows:

(a) The allegations of Paragraph 13(a) are admitted, but the allegation that such action is incorrect or illegal is denied.

(b) The allegations of Paragraph

13(b) are admitted, but the allegation that such action is incorrect or illegal is denied.

(c) The allegations of Paragraph 13(c) are denied.

(d) The allegations of Paragraph 13(d) are denied.

14. Defendant lacks knowledge of the allegations of Paragraph 14 sufficient to admit or deny them, and therefore denies them.

15. The allegations of Paragraph 15 are admitted.

16. The allegations of Pargraph 16 are admitted.

17. The allegations of the first sentence of Paragraph 17 are admitted. Defendant denies that the allegations of the second sentence of Paragraph 17 are applicable or material in this proceeding.

18. The allegations of Paragraph 18

are admitted.

19. The allegations of Paragraph 19 are admitted.

20. The allegations of Paragraph 20 are admitted.

21. The allegtions of Paragraph 21 are denied.

22. The allegations of Paragraph 22, and all subparagraphs, are denied.

23. Defendant lacks knowledge of the allegations of Paragraph 23 sufficient to admit or deny them, and therefore denies them.

24. Defendant admits that its audit schedules for 1974 reflect a Florida property factor in the apportionment formula of .003601. Defendant denies the remaining allegation of Paragraph 24.

25. The allegations of Paragraph 25 are denied.

26. The allegations of Paragraph 26 are denied.

27. The allegations of Paragraph 27 are admitted.

28. In response to Paragraph 28, Defendant would state that the cited statute speaks for itself. Defendant admits the second sentence of Paragraph 28.

29. The allegations of Paragraph 29 are admitted.

30. Defendant admits that it sent Plaintiff a revised Proposed Notice of Deficiency on August 11, 1977, in which the December 14, 1976 Notice of Deficiency was enlarged for the years in controversy. Defendant denies the remaining allegations of Paragraph 30.

All matters not specifically admitted are hereby denied.

FIRST DEFENSE

Defendant, for its First Defense, alleges that Plaintiff is estopped to assert relief based on the Defendant's

exclusion of intangible drilling and development costs from the property factor of the apportionment formula because of Plaintiff's election to treat these costs as expenses for federal and Florida income tax purposes.

SECOND DEFENSE

Defendant, for its Second Defense, alleges that Plaintiff waived, or is estopped from asserting, any claim based on the statute of limitations by virtue of its election to pursue informal administrative remedies within the Defendant.

Respectfully submitted,

JIM SMITH
ATTORNEY GENERAL

E. Wilson Crump, II
Ass't Attorney General

David K. Miller
Ass't Attorney General
Dept. of Legal Affairs
The Capitol, Room LL04
Tallahassee, FL 32301
(904)487-2142

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the ANSWERS AND DEFENSES TO AMENDED COMPLAINT has been furnished by U.S. mail to Hume F. Coleman, P.O. Drawer 810, Tallahassee, Florida, 32302, Stanley W. Rosenkranz and Robert B. Glenn, Jr., P.O. Box 1288, Tampa, Florida 33601, this 4th day of August, 1980.

David K. Miller
Ass't Attorney General

Appendix 4

IN THE CIRCUIT COURT OF THE
SECOND JUDICIAL CIRCUIT, IN
AND FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff, CASE No. 80-987

vs.

DEPARTMENT OF REVENUE
OF THE STATE OF FLORIDA,

Defendant. /

A F F I D A V I T

STATE OF FLORIDA

COUNTY OF LEON

BEFORE ME, the undersigned notary public authorized in the state and county named above to administer oaths and take acknowledgements, personally appeared Larry Churchill, who, being by me first duly sworn, deposes and says:

1. I was employed as a corporate income tax auditor with the Department of Revenue, State of Florida, from January, 1974 to December, 1978. From January 1,

1979 to June 30, 1979, I was the Acting Section Administrator for the Audit Classification Section. On July 1, 1979, I was appointed Section Administrator for the Audit Classification Section. Since August 2, 1982, I have been employed with the House Minority Office of the Florida Legislature. I have personal knowledge of the facts set forth herein.

2. The Department of Revenue, State of Florida, has the responsibility of regulating, controlling and administering all revenue laws and performing all other duties provided in Chapter 220, Florida Statutes ("income tax code").

3. In my capacity as a corporate income tax auditor, I was assigned the responsibility of auditing Shell Oil, a company generally engaged in the oil and gas business and authorized to do business in the State of Florida.

4. Shell Oil extracts oil from

wells on the Outer Continental Shelf (OCS). All refining and most marketing of OCS oil occurs within the continental United States. A portion of Shell Oil°s net income for the years 1972, 1973, 1974 and 1975 came from sales of OCS oil.

5. For the years 1972, 1973, 1974 and 1975, Shell Oil placed a value on its OCS oil for accounting and federal income taxation purposes. According to Shell Oil, this value is the fair market value, at the wellhead, of OCS oil, less related costs and expenses.

6. In each of its Florida income tax returns for 1972, 1973, 1974 and 1975, Shell Oil excluded from its income, determined for federal income tax purposes, its wellhead fair market value of OCS oil, less related costs and expenses. Shell also excluded OCS property, OCS payroll and a wellhead fair market value of OCS oil from the denomi-

nators of the property, payroll and sales factors of the apportionment formula contained in §214.71, F.S., as modified by §220.15, F.S.

7. For federal income tax purposes, Shell Oil expenses (i.e., writes off for the current year) intangible drilling costs.

8. In its Florida income tax returns for 1972, 1973, 1974 and 1975, Shell Oil included all costs of its offshore oil wells, including intangible drilling costs, in the property fraction of the Apportionment Formula.

9. During my audit of Shell Oil, I restored the fair market value, at the wellhead, of OCS oil to the sales factor for the apportionment formula. While adjusting the sales factor, I mistakenly added the OCS property and payroll "values" to the property and payroll factors.

Upon review of my audit work papers by corporate income tax personnel this error was found. The Department of Revenue issued a corrected proposed audit deficiency on August 11, 1977.

_____

LARRY CHURCHILL

SWORN TO AND SUBSCRIBED BEFORE ME THIS 15th DAY OF September, 1982.

_____

Notary Public

My Commission Expires October 1, 1974.

Appendix 5

IN THE RECORD AS PART OF EXHIBIT H TO AFFIDAVIT OF J. L. KENNEDY

February 4, 1980

Shell Oil Company
One Shell Plaza
Post Office Box 2463
Houston, Texas 77001

Attention: J. O. Lewter, Manager
State Income Taxes

RE: Protest
Florida Corporate
Income Tax
Deficiencies
FEI: 13-129-9890
FYE: 12/31/72,
12/31/73, 12/
31/74 & 12/31/
75

Dear Mr. Lewter:

We are enclosing a revised report of the above referenced tax years which reflects the Department's revised determination of the correct income tax deficiencies for the years ending December 31, 1972 through 1975.

The revised report takes into account all the issues which were raised

in the taxpayer's protests dated February 4, 1977 and October 3, 1977, and in the taxpayer's letters of May 15, 1978 and November 6, 1979.

Among the concessions made to the taxpayer is the allowance of the 1975 excess statutory depletion over federal depletion in the amount of $277,141,895.00 and the allowances of capitalized royalties as set forth in your letter of November 6, 1979.

According to the audit report dated August 10, 1977, the 1975 capitalized royalties claimed per return amounted to $1,615,085,488.00 (thereby being over-stated by $82,314,016.00). This excess accounts for the difference between the capitalized rentals claimed on Line 5, Schedule III-C of the F-1120 and the amount allowed on Line 4, Schedule I C, page 15 of the revised report.

Since you already have in your

possession, the Department's letter dated April 19, 1977, in reply to your original protest, and the Department's letter of August 11, 1977, in response to the informal conferences (March 1, 1977 and July 21, 1977) it is considered unnecessary to elaborate on those audit adjustments that had been sustained in the original Notice of Decision.

Attention is invited to the Department's letters to Mr. Norman E. Rusch, dated July 20, 1979 and September 19, 1979, which set forth the Department of Revenue's final positions with respect to those issues that are peculiar to the oil industry. The letter of July 20, 1979, affirms the Department's positions that O.C.S. property and payroll, as well as the expended intangible drilling and development costs are not includable in the apportionment factors.

Finally, in response to the

supplemental protest filed by Mr. J. L. Kennedy, Tax Attorney, under date of October 3, 1977, the Department's positions with respect to designated "new" issues are stated as follows:

Issue IIA - Year Barred from Adjustment - 1972

We cannot agree that the statutory period of limitations has run as against the proposed assessment for the year 1972 as it relates to the adjustments discussed under Issues IIB and VI below.

Nor can we agree that the Department has enlarged such prior proposed assessments.

The facts that we have before us at this point in time indicate the following:

(a) That the 1972 Florida form 1120 was filed on September 24, 1973, pursuant to a timely requested extension date of October 1, 1973;

(b) That the normal statutory period for 1972 assessment of tax ran (because of the timely filed and granted extension) until three years from October 1, 1973, or until October 1, 1976;

(c) That the statutory period for the assessment of additional Florida corporate income taxes deemed due for the year 1972 had been timely extended to December 31, 1976, as of July 19, and 22, 1976;

(d) That the Florida Notice of Deficiency covering the year 1972, as well as the years 1973, 1974 and 1975, was issued to Shell Oil Company on December 14, 1976;

(e) That the Department's Notice of Decision relative to the years involved was issued under date of August 11, 1977; and,

(f) Finally, that our Notice of Decision

generated a request for reconsideration as filed on behalf of Shell Oil Company under date of October 3, 1977.

The above facts, particularly as tothe dates involved, tend to crystallize the pivotal considerations here regarding Section 214.09, Florida Statutes, and urge us to comments contra to those which have already been made (we believe erroneously) in the request for reconsideration.

Section 214.09(1)(a), Florida Statutes, requires the timely issuance of the Department's Notice of Deficiency within three years after the date that a particular return is filed.

In the instant situation, this condition has been appropriately satisfied since the Notice of Deficiency covering the year 1972 was issued on December 14, 1976, which date fell within the extended statutory period that termi-

nated on December 31, 1976. In this regard, we feel fully supported by the following language of Section 214.09(4), Florida Statutes:

> "If, before the expiration of the time prescribed in this section for the issuance of a notice of deficiency, both the department and the taxpayer have consented in writing to its issuance after such time, such notice may be issued at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon." *(Under-scoring added)

Upon the execution of a consent to extend the period in which a Notice of Deficiency may be issued (as was done in the instant case via the extension of the assessment date) the time for making any assessment is then further extended for the period in which the making of an assessment is prohibited and for 60 days thereafter. (Underscoring added)

This requirement is statutorily defined by the following provision of

Section 214.03(2) and 214.11(4), Florida Statutes:

> "Whenever a notice of deficiency has been issued, the amount of the deficiency shall be deemed assessed on the date provided in s. 214.08 if no protest is filed or, if a protest is filed, on the date when the decision of the department with respect to the protest becomes final, as provided in s. 214.11(4)."
>
> "The decision of the department on any taxpayer's protest shall become final 60 days after issuance of a notice of decision under subsection (2) unless a timely request for reconsideration was made under subsection (3), in which case the decision shall become final upon the issuance of a notice of denial of such request or the issuance of a notice of decision on reconsideration." (Underscoring added)

Consistent with all the above, it is the Department's position that the Notice of Deficiency was in fact, issued timely in accord with the cited Florida Statutes and because it was, so was our Notice of Decision dated August 11, 1977.

In view of this established timeliness any amendment to the 1972 Florida

corporate income tax as reflected in the Notice of Deficiency dated December 14, 1976, were proper and not the result of "new issues" but rather an affirmation of our consistent position regarding the Outer Continental Shelf (O.C.S.) aspects already reported to Shell Oil Company and identified in both its protest and request for reconsideration as Issues I, II and III.

Issue IIB - Outer Continental Shelf Property and Payroll

Apropos of the above, we do not regard this particular issue as "new". We do, however, feel that remarks supplementing those as reflected on page five of our Notice of Decision dated August 11, 1977, should issue at this time and thus serve as a reply to the additional points raised regarding O.C.S. property and payroll in the request for a reconsideration.

At first blush it would appear that since the Department of Revenue is attempting to tax the income from Shell Oil Company's O.C.S. oil production that in deference to basic equity it should permit the inclusion of O.C.S. property and payroll values in the factoring denomintors of the years being contested.

Such a simplistic proposition would have to receive some sort of recognition if it squared with the facts which it does not since Florida is not taxing O.C.S. income but is taxing the ultimate sales of such production after it is piped, barged or boated to domestic refinery facilities.

In short, such sales, based on the facts presently before us, are non-severable from total sales domestically, and even if they were, our view is that they would still be domestic and not foreign sourced since the O.C.S. to date

has not been identified as being other than part of the total United States (as was Puerto Rico in the Heftler Construction Company case.)

This being the situation then such sales are beyond the relief afforded by Section 220.13(2)(b), Florida Statutes. In short, such sales clearly are not "foreign situs".

This we believe is the prime dispositive consideration which severs the need to consider our proposed taxing of O.C.S. income and our denial of property and payroll values in the factoring denominators as being related.

Having eliminated the alleged tie between the proposed O.C.S. sales adjustments and the property and payroll exclusions, we now address additional remarks to these latter aspects which support the position we have already taken on page five of our Notice of Decision.

We do not agree that our exclusion of property and payroll values from factoring denominators is in violation of the provisions in 43 U.S.C.A.1333(a)(2). Indeed, we believe that our position defers to this federal statute.

In this regard, Section 220.15(3), Florida Statutes, provides that:

> "The term 'everywhere' in part IV of chapter 214, which is used in the computation of apportionment factor denominators, shall mean 'in all states of the United States, the District of Columbia, or any political subdivision of the foregoing'; and"

Furthermore, the following language of 43 U.S.C.A. 1332(a) clearly precludes any claim of ownership or possession by any state in O.C.S. lands:

> "It is declared to be the policy of the United States that the subsoil and seabed of the Outer Continental Shelf appertain to the United States and are subject to its jurisdiction, control, and power of dispostion as provided in this subchapter."

This being the case then it appears that the Department is precluded from the

inclusion of O.C.S. property and payroll in factoring denominators because of the language of 43 U.S.C.A. 1333(a), which identifies such property and payroll as having a United States but not a Florida situs and thus places such values beyond the reach of Section 220.15(3), Florida Statutes.

This premise has been strengthened and the validity of the Outer Continental Shelf Lands Act itself recognized by the United States Supreme Court (95 S.Ct. 1155-1975) in its decision of March 17, 1975, which set to rest all previous state claims of ownership of O.C.S. lands when it ruled that the United States and not contiguous coastal states, had sovereign rights over both the seabed and subsoil of the Shelf.

Consistent with all the above, we reaffirm the exclusion of the O.C.S. property and payroll values from the

factoring denominators in each of the years 1972, 1973, 1974 and 1975.

In reply to your Issue V of the protest dated October 3, 1977, it is the Department's position that the dictates of Section 220.15, Florida Statutes, as quoted below, should be followed in computing the formulary apportionment as prescribed by Section 214.71, Florida Statutes.

> "220.15 Apportionment of adjusted federal income.-Adjusted federal income as defined in s.220.13 shall be apportioned to this state in accordance with part IV of Chapter 214, and for the purpose of applying said part to this code:...
>
> "(4) In lieu of the equally weighted three-factor apportionemnt fraction based on property, payroll and sales which is described in s. 214.71, there shall be used for purposes of the tax imposed by this code an apportionment fraction composed of a sales factor representing 50 percent of the fraction, a property factor representing 25 percent of the fraction, and a payroll factor representing 25 percent of the fraction."

On the other hand, if it is found

that the taxpayer is paying tax on an excess of 100% of federal taxable income, due consideration will be given to an application for relief under Subsection 220.15(4)(a), Florida Statutes, as prescribed below:

> "However, upon application in accordance with paragraph (a), any taxpayer shall be entitled to a refund of tax, in the amount determined under paragraph (b), if it can establish that the aggregate amount of its net income subject to tax under this code and in all other states for the taxable year exceeds 100 percent of the taxpayer's taxable income, as determined for federal income tax purposes, for the taxable year.
>
> "(a) Any taxpayer eligible for a refund under this subsection shall make application therefore in accordance with procedures set forth in part I of chapter 214. All applications for refund under this subsection shall be accompanied by a copy of the taxpayer's federal income tax return for the taxable year, copies of every return filed by the taxpayer in the states in which it has conducted business for the taxable year, and verification in the form of cancelled checks or other receipts of the taxpayer's payments of the amounts shown to be due on the several returns filed with the refund application."

"(b) The refund to which any taxpayer shall be entitled under the subsection shall be equal to 5 percent of the lesser of:

"1. The excess of the amount subject to tax for the taxable year under this code over the amount which would have been subject to tax if the taxpayer had computed net income for purposes of this code on the basis of the apportionment fraction described in s. 214.71; or

"2. The excess of the aggregate amount of net income subject to tax in Florida and in all other states for the taxable year over the amount of federal taxable income for the taxable year.

"(c) For purposes of this subsection, the terms 'net income subject to tax' and 'amount subject to tax' shall mean the amount against which a rate or rates are applied in determining the taxpayer's dollar liability for tax in any jurisdiction."

Issue VI - Mechanical Errors

The points raised in your request for reconsideration, relative to various mechanical errors in the computations, forwarded to you as part of the Department's transmittal dated August 11, 1977, have all been found valid and appropriate corrections are now reflected

on each DOR 802 in the revised audit report enclosed.

If you now agree, please complete the enclosed form DOR-870 and return it to this office. If you do not agree, please note the appeal options described at 2.b. on the form DOR-890 also being forwarded.

Your cooperation in this matter will be greatly appreciated.

Sincerely,

George J. Yore
Tax Conferee
Disposition Section

GJY/pm
Enclosures

Appendix 6

IN THE CIRCUIT COURT FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff,

vs. CASE NO. 80-897

DEPARTMENT OF REVENUE OF THE STATE OF FLORIDA.

Defendant. /

MOTION TO AMEND

Plaintiff Shell Oil Company moves the court for leave to amend its Amended Complaint in this case to delete paragraphII of the prayer for relief contained on page 7 of the Amended Complaint.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing has been furnished by U.S. Mail to Thomas L. Barnhart, Assistant Attorney General, Department of Legal Affairs, The Capitol, Room LL04, Tallahassee, Florida 32301, attorney for Defendant, this 23rd

day of February, 1983.

Robert B. Glenn, Jr. of
HOLLAND AND KNIGHT
Post Office box 1288
Tampa, Florida 33601
(813) 223-1621
Attorneys for Plaintiff

133930001Smot1:69

Appendix 7

IN THE CIRCUIT COURT OF
THE SECOND JUDICIAL
CIRCUIT, IN AND FOR LEON
COUNTY, FLORIDA.

SHELL OIL COMPANY,

Plaintiff,

vs. CASE No. 80-987

DEPARTMENT OF REVENUE
STATE OF FLORIDA

Defendant. /

DEFENDANT'S INITIAL INTERROGATORIES
TO PLAINTIFF

Omitted through 28

29. (a) Does Plaintiff sell any of the products from its OCS production operations to purchasers not affiliated with Plaintiff in sales which take place outside the 50 states and District of Columbia?

Yes, the Plaintiff sells some of its oil and gas production to independent purchasers on the OCS, which is outside the 50 states and District of Columbia.

(b) Where are these sales made (i.e., at the wellhead, in foreign ports?

They are made at or near the off-shore wellhead.

(c) What percentage of Plaintiff's total OCS production (in barrels, cubic feet, etc.) was sold in the sales described in interrogatory 29(a) for each year in controversy?

1972	1973	1974	1975
17.5%	21.4%	22.5%	19.2%

Note: These percentages were computed by reference to dollar values, not volumes. The information needed to answer on a volume basis was not readily available. If this information will not serve the immediate purpose, please so advise.

Omitted 30 through 35.

Respectfully submitted,

JIM SMITH
ATTORNEY GENERAL

David K. Miller
Ass't Attorney General
Dept. of Legal Affairs
The Capitol, Room LL04
Tallahassee, Florida
(904)487-2142
COUNSEL FOR DEFENDANT

I HEREBY CERTIFY that the foregoing answers are true and correct, to the best of my knowledge, information and belief .

For Plaintiff B. G. Weir
Tax Officer

STATE OF TEXAS
COUNTY OF HARRIS

B. G. Weir, being duly sworn, deposes and says that the attached Answers to Defendant's Initial Interrogatories to Plaintiff are true and correct to the best of his knowledge, information and belief.

Sworn to and subscribed before me this 30th day of September, 1980.

Notary Public
My Commission Expires
November 17, 1981

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the original of the foregoing Defendant's Initial Interrogatories to Plaintiff and Answers thereto was mailed to the Clerk of the above-styled court for filing and copy of same was mailed to David K. Miller, Assistant Attorney General, this 3rd day of October, 1980.

_____

Attorney for Plaintiff

Appendix 8

IN THE CIRCUIT COURT FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY

Plaintiff

vs. CASE NO. 80-987

DEPARTMENT OF REVENUE
OF THE STATE OF FLORIDA

Defendant.
_____/

SHELL OIL COMPANY'S
MOTION FOR SUMMARY JUDGMENT

Plaintiff Shell Oil Company ("Shell") moves the court for summary judgment in its favor and against Defendant Department of Revenue of the State of Florida (the "Department") on the grounds that the pleadings and answers to interrogatories filed in this case and the affidavits attached to this motion show that there is no genuine issue as to any material fact and that Shell is entitled to judgment as a matter of law. The following are the more

specific grounds upon which this motion is based and the substantial matters of law to be argued.

1. The Department's treatment of Shell's income derived from its production business on the Outer Continental Shelf ("OCS") violates the Outer Continental Shelf Lands Act, 43 U.S.C. §1333(a)(2).

2. If Shell's income derived from its production business on the OCS should be included in Shell's net income for Florida income tax purposes, such income should be apportioned to Florida by the apportionment formula contained in Section 214.71, Florida Statutes, as modified by Section 220.15, Florida Statutes (the "Apportionment Formula"), or by the Apportionment Formula as further modified by including OCS property, payroll, and sales in denominators of the Apportionment Formula.

3. The Department unlawfully refused to allow Shell to include all of its original cost of oil and gas wells, particularly its intangible drilling and development costs in the property fraction of the Apportionment Formula.

4. The Department's audit, upon which its assessment are based, contains a mathematical error in the calculation of the property factor of the Apportionment Formula for 1974, causing an overstatement of Shell's tax liability by $5,504.00.

5. A portion of the Department's assessment for 1972 is barred by the applicable statute of limitations.

Robert B. Glenn, Jr. and
Stanley W. Rosenkranz, of
HOLLAND AND KNIGHT
Post Office Box 1288
Tampa, Florida 33601
(813)223-1621
Attorneys for Plaintiff

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing motion for summary judgment has been furnished by U.S. Mail to E. Wilson Crump, II and David K. Miller, Assistant Attorneys General, Department of Legal Affairs, The Capitol, Room 1104, Tallahassee, Florida 3301, attorneys for Defendant, this 2nd day of October, 1981.

_____

Robert B. Glenn, Jr.

AFFIDAVIT OMITTED

Appendix 9

IN THE CIRCUIT COURT FOR LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff,

vs. CASE NO. 80-987

DEPARTMENT OF REVENUE OF THE STATE OF FLORIDA.

Defendant. /

AMENDMENT TO MOTION FOR SUMMARY JUDGMENT

Plaintiff Shell Oil Company amends its motion for summary judgment previously filed in this case to delete paragraph 2 of the motion and the grounds stated therein. Plaintiff does not intend to abandon the grounds set forth in paragraph 2 for all purposes but withdraws such grounds for purposes of its motion for summary judgment.

I HEREBY CERTIFY that a copy of the foregoing has been furnished by hand delivery to Thomas L. Barnhart, Assistant Attorney General, Department of Legal

Affairs, The Capitol, Room LL04, Tallahassee, Florida 32301, Attorney for Defendant, this 19th day of November, 1982.

Robert B. Glenn, Jr., of
HOLLAND & KNIGHT
Post Office Box 1288
Tampa, Florida 33601
(813) 223-1621
Attorney's for Plaintiff

Appendix 10

IN THE CIRCUIT COURT
OF THE SECOND JUDICIAL
CIRCUIT, IN AND FOR
LEON COUNTY, FLORIDA

SHELL OIL COMPANY,

Plaintiff,

vs. CASE No. 80-987

DEPARTMENT OF REVENUE,
STATE OF FLORIDA,

Defendant. /

DEPARTMENT OF REVENUE'S MOTION FOR SUMMARY JUDGMENT

Defendant, Department of Revenue, State of Florida, ("Department") moves this court for summary judgment in its favor and against Plaintiff Shell Oil Company ("Shell") on the grounds that the pleadings and answers to interrogatories and the affidavits filed in this case show that there is no genuine issue as to any material fact and that the Department is entitled to judgment as a matter of law. The following are the more specific

grounds upon which this motion is based and the substantial matters of law to be argued:

1. The Department's treatment of Shell's income derived from its production business on the Outer Continental Shelf ("OCS") does not violate the Outer Continental Shelf Lands Act, 43 U.S.C. §1333(a)(2).

2. The Department cannot lawfully allow Shell to include property located on the OCS and compensation paid to employees on the OCS in the denominators of the property and payroll factors of the apportionment formula pursuant to §214.71, F.S., as modified by §220.15, F.S.

3. Shell should not be allowed to include its intangible drilling and development costs in the property fraction of the Apportionment Formula.

4. The Department's assessment for

1972 is not affected by the applicable statute of limitations.

Respectfully submitted,

JIM SMITH
ATTORNEY GENERAL

Thomas L. Barnhart
Ass't Attorney General
Dept. of Legal Affairs
The Capitol, LL04
Tallahassee, FL 32301
(904) 487-2142

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing DEPARTMENT OF REVENUE'S MOTION FOR SUMMARY JUDGMENT has been furnished by hand on the 19th day of November, 1982 to ROBERT B. GLENN, Jr., Esquire, P.O. Box 1288, Tampa, Florida 33601.

Thomas L. Barnhart
Ass't Attorney General

Appendix 11

In the Supreme Court of Florida

Shell Oil Company, Petitioner	)	
v.	)	Case Nos. 66,240 66,254
Department of Revenue, Respondent.	)	

On Review from the District Court of Appeal, First District

Petitioner's Initial Brief

Elizabeth C. Burton,
Tax Attorney
Shell Oil Company
P. O. Box 2463
Houston, Texas 77001
(713) 241-2414

Arthur J. England, Jr., Esq.
Sandra S. Barker, Esq.
Fine Jacobson Schwartz Nash Block & England, P.A.
2401 Douglas Rd.
Miami, FL 33134
(305) 446-2200

PAGES 1 - 4 OMMITTED

Shell has invoked the Court's discretionary jurisdiction, on the basis of the district court's certified question, in order to obtain a declaration that the exclusion of all Outer Continental Shelf income from Florida's income tax is required by Florida and federal law. As to the apportionment issue discussed in the district court's opinion, which involves only how much of the income earned by a multi-state enterprise may be attributed to Florida as opposed to what items actually compose the amount of taxable income itself, Shell believes the district court has mistakenly sanctioned an unconstitutional distortion of

Florida's apportionment formula.[4] That is, the court has allowed the formula for attributing to Florida a portion of Shell's nationwide business activities to skew Florida's share in a way which affronts the United States Constitution and federal law. To avoid confusion on the important "exclusion" issue, however, Shell elects not to argue the apportionment issue before the Court.

PAGES 6 - 33 OMMITTED.

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[4]The appropriate correlation of includable income items, and the formula for apportioning that income to Florida, was identified in Heftler Construction Co. v. Department of Revenue, 334 So.2d 129 (Fla. 3d DCA 1976), cert. denied, 341 So.2d 1082 (Fla. 1977). Cf. Continental Illinois National Bank & Trust Co. v. Lenckos, 464 N.E.2d 1064 (Ill.), cert. denied, 105 S.Ct. 296 (1984); see also Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983), describing the necessity for an apportionment formula which contains both internal and external consistency.

Certificate of Service

I certify that a true and correct copy of this brief was mailed on March 4, 1985 to Joseph C. Mellichamp, III, Esq., Assistant Attorney General, Department of Legal Affairs, The Capitol, Tallahassee, Florida 32301, counsel for the Department of Revenue.

Arthur J. England, Jr., Esq.
Sandra S. Barker, Esq.
Fine Jacobson Schwartz Nash
Block & England, P.A.
2401 Douglas Road
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(305) 446-2200

Appendix 12

IN THE SUPREME COURT OF THE

STATE OF FLORIDA

SHELL OIL COMPANY,

Petitioner,

vs. Case Nos. 66,240 and 66,254

DEPARTMENT OF REVENUE,

Respondent.

_____/

Motion for Rehearing

Pursuant to Rule 9.330, Fla. R. App. P., and the order of the Court extending the time for rehearing until May 20, Shell Oil Company moves for rehearing and requests that the Court reconsider its decision of April 24, 1986. Shell respectfully suggests that:

(i) with respect to the issue of intangible drilling costs (IDCs), the Court has both overlooked a decision of the Oregon Supreme Court which has reversed an Oregon tax court decision on

which the Court has relied, and it has misapprehended the effect of the treasury regulation on which the Court has relied; and

(ii) the Court has overlooked an unconstitutional consequence of now holding that the state in this case may tax net revenues derived from Shell's production of oil and gas on the Outer Continental Shelf (OCS).

As to IDCs

1. The Court has held that IDCs which are expensed for federal income tax purposes, rather than capitalized, may not be included in the property factor of the state's apportionment formula. Some of the reasons offered by the Court actually seem to be at odds with the result reached on the basis of those reasons. The bases for the Court's determination seem to be three:

(a) that Shell elected to expense

IDCs, and "thereby voluntarily subjected itself to the restriction of treasury regulation section 1.1016-2" (Shell Oil Co. v. Department of Revenue, 11 F.L.W. 186 (Fla. April 24, 1986);

(b) consistency with other states as reflected in decisions of the tax court of Oregon and an agency in California (id.); and

(c) the district court's disregard of both the Department's regulation (12C-1.15(4)(b)(5)) and a statute (section 220.42(1)) which requires consistency between state and federal methods of accounting (id.).

(a) expensed IDCs. The Court has cited treasury regulation 1.1016-2(a) (1957) for the proposition that expensed IDCs do not give rise to a basis adjustment. Shell would note that neither party cited or referenced this regulation in its briefs, in all

probability because the regulation bears on the computation of tax basis rather than the wholly different concept of attributing income among multiple taxing jurisdictions by means of an apportionment formula. The two subjects are unrelated. See Shell's reply brief at pages 16-19.

Should the Court choose to rely on this regulation, however, Shell suggests that the Court's analysis of the regulation is accurate but respectfully notes that the regulation supports Shell's treatment of IDCs, rather than the Department's. Yet the Court has held for the Department on this issue.

The unadjusted tax basis of property, such as would be required for expensed IDCs under the regulation which the Court has identified, is original cost. Section 214.71(1)(a), Florida Statutes. Shell in fact treated IDCs on

its Florida tax return at original cost, and has asserted that to be the proper basis in its argument to this Court. The federal regulation referenced by the Court supports Shell's treatment of IDCs. If Shell has voluntarily subjected itself to this regulation, as the Court has stated, it should prevail on this issue.

(b) consistency. The Court has stated it wishes to be consistent with other states in the treatment of IDCs for apportionment purposes. Shell agrees that Florida should be consistent with other states. The Court has misapprehended the position of the other states on IDCs, however.

The Oregon tax court decision which was relied on by the Court on this issue was reversed by the Oregon Supreme Court on April 1, 1986. A copy of the Oregon decision, entitled Atlantic Richfield Co.

v. Department of Revenue, was filed with the Court, without argument, in Shell's Notice of Supplemental Authority dated April 4, 1987.* Undoubtedly the decision of the Oregon Supreme Court was simply overlooked by the Court when the decision in this case was released.

The Oregon Supreme Court, like this Court, predicated its decision on uniformity and consistency among the states. The Oregon high court identified several states that treat IDCs for apportionment purposes in the manner that Shell has proposed -- states not mentioned by this Court in its opinion. The Oregon Supreme Court concluded its analysis by stating:

---

* Shell would call to the court's attention that a petition for rehearing is presently pending before the Oregon Supreme Court.

> In order to meet the UDITPA "uniformity" criterion, we hold that IDCs should be included in "original cost." (Slip opinion at page 14.)

Consistency with other states on the treatment of expensed IDCs also requires that Shell prevail on this issue.

(c) district court errors. In reversing the district court as to IDCs, the Court has stated that the district court ignored both the original cost regulation, Rule 12C-1.15(4)(b)(5) as promulgated by the Department, and section 220.42(1), Florida Statutes. Clearly, there is some confusion here. The district court did not ignore the original cost regulations. In ruling for Shell on this issue it followed, indeed relied on, Rule 12C-1.15(4)(b)(b)(5).

> Shell's procedure conforms to the Department's rule. (Shell Oil Co. v. Department of Revenue, 9 F.L.W. at 770 (Fla. 1st DCA 1984).

It was the Department which had argued against the Rule, by suggesting to the district court that it is not applicable to IDCs. If the Rule is not to be ignored, as the Court implies, this is yet another reason that Shell should prevail on this issue.

The Court has also apparently misapprehended section 220.42(1)'s application to this proceeding when it declared that it provides a "clear mandate" for the exclusion of IDCs from the property factor of the apportionment formula. By its express terms, section 220.42(1) was enacted and applies only "for purposes of the income tax code" -- to wit, chapter 220, Florida Statutes. Apportionment is not determined by the income tax code. It is prescribed in chapter 214, Florida Statutes, entitled "Administration of Designated Nonproperty Taxes." It would seem that the Court

confused accounting requirements for computing a taxpayer's income under the income tax code, with the non-accounting determination of property factors in the formula for administering various tax laws.

As to OCS production income

2. Based on the "realization" of taxable income at the time refined oil products are sold in the United States, the Court has approved the district court's decision to the effect that the OCS Lands Act ddoes not bar the State of Florida from taxing Shell's OCS production income. In so doing, however, the Court has inadvertently abridged the constitutional limitations on state income taxation which are set forth in Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983).

Florida has now taxed all of Shell's net income, including that derived from

production activities on the Outer Continental Shelf. But Florida's apportionment formula has not taken into account the payroll or property Shell expended in the course of producing OCS income. Those enormous sums are simply disregarded, as if no money had been used in extracting oil and gas from beneath the sea. See Shell Oil Co. v. Department of Revenue, 9 F.L.W. 769 (Fla. 1st DCA 1984). That is the situation this Court has now approved, and therein lies the problem.

A brief explanation of the difficulty is necessary, as the problem was not manifest before the Court's decision.* Consequently, no prior analysis has been given. The Court may find it helpful to order additional briefs on this issue.

---

* In its initial brief, Shell mentioned this difficulty. (See

Container's mandatory tests for internal and external consistency are met in only one of two ways. Either a state must accord separate accounting treatment to OCS income, by "backing-out" OCS income to reflect the mandate of section 1333(a)(2), or a state must apply a constitutionally fair apportionment methodology with respect to multistate net income by providing so-called "factor relief" in the apportionment formula.

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* Continued.

page 5.) Shell's contention that OCS production income is excludable from the tax base made discussion of the district court's defective apportionment unnecessary. The fact that Shell chose not to discuss the apportionment issue, for ease of argument, did not eliminate the constitutional difficulty. Now that the Court has placed its stamp of approval on the district court's opinion (see Shell Oil Co. v. Department of Revenue, 11 F.L.W. at 186 (Fla. April 24, 1986), Shell would be remiss if it did not advise the Court that it has sanctioned an unconstitutional methodology for state income taxation.

Shell had urged the first approach by asking the Court to exclude OCS production income from Shell's tax base, but the Court has rejected that position. The consequence of that rejection is approval of the district court's tax levy on a distorted, and unconstitutionally skewed apportionment methodology.

Formula apportionment is the method commonly used to divide the income of a unitary business among various jurisdictions in which the business operates. This was the method used by the Florida Department of Revenue in this case. The formula method, "unlike separate accounting, does not purport to identify the precise geographical source of a corporation's profits; rather, it is employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted

within the taxing State." Moorman Manufacturing Co. v. Bair, 437 U.S. 267, 273 (1978).

The formula method assumes that the total income of a business enterprise results from certain income-producting factors -- typically property, payroll and sales. The value of the corporation's property, payroll and sales within the taxing state is compared to the value of those factors everywhere -- both inside and outside the taxing state. The resulting ratio is then applied to the taxpayer's total apportionable net income.

A state, of course, cannot arbitrarily choose a formula by which to apportion income. The chosen formula must be judged to be fair under the tests articulated in the Container decision. The tests of Container are referred to by that Court as the internal and the

external consistency tests. Container Corp. of America v. Franchise Tax Board, 463 U.S. at 169.

(a) internal consistency. This test was originally established as the uniform application rule in Moorman Manufacturing Co. v. Bair, 437 U.S. 267 at 276-277 and n. 12. It was restated as a rule of internal consistency in the Container decision (463 U.S. at 169):

> (T)he formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed.

The rule of internal consistency is complicated and technical. The tax method approved by the Court for application to Shell's income does not meet the internal consistency test. Unfortumately, it would require a rather lengthy explanation and set of examples to explain why. As this motion is not the place for that type of analysis, further

briefing of the issue would seem appropriate.

(b) external consistency. This test of the required fairness in an apportionment of taxable income is also set out in Container (463 U.S. at 169):

> the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.

The Court's application of the Florida formula against Shell's income flunks this test.

The Court has sanctioned a result which says, in effect, that there have been no applications of property or payroll on the OCS which contributed to the generation of Shell's income. Florida's formula, of course, recognizes that income is attributable to other locales in which payroll and property are present. By pretending that Shell expended no payroll and used no property

to generate OCS revenues, Florida over-attributes income to itself in a way which violates the external consistency test of Container.

WHEREFORE, Shell respectfully requests that the Court reconsider its April 24 opinion and decision for the reasons expressed. As the Court may find further oral argument to be helpful, Shell has filed a motion requesting same. Shell also stands ready to provide additional briefing on these issues.

Respectfully submitted,

Wm. D. Peltz,
Sr. Tax Counsel
-and-
Elizabeth C. Burton,
Tax Attorney
Shell Oil Co.
P. O. Box 2463
Houston, TX 77001
(713) 241-2414

Arthur J. England, Jr., Esq.
Fine Jacobson Schwartz Nash Block & England P.A.
2401 Douglas Rd.
Miami, Florida 33134
(305) 446-2200

Certificate of Service

I certify that true and correct copies of this motion were mailed on

May 19, 1986 to Joseph C. Mellichamp, III., Esq., Assistant Attorney General, The Capitol, Tallahassee, Florida 32301, and to Sharon A. Zahner, Assistant General Counsel, Department of Revenue, Carlton Building, Tallahassee, Florida 32301.

By: _____

Appendix 13

IN THE SUPREME COURT

OF THE STATE OF FLORIDA

SHELL OIL COMPANY,

Petitioner,

vs. CASE NOS. 66,240 & 66,254

DEPARTMENT OF REVENUE,

Respondent.
_____/

RESPONSE TO MOTION FOR REHEARING

Shell Oil Company ("Shell") moved for rehearing and requested this Court reconsider its decision of April 24, 1986 rendered in this cause. This Court by order extended the time for filing response of the Department of Revenue ("Department") to June 4, 1986. The Department responds hereby and respectfully urges this Court to deny Shell's motion for the reasons that this Court's standing decision is precisely

correct (as explained hereinafter) but rather each of Shell's recitations of error alleged as inherent in that decision are fatally flawed.

As stated by Shell in its motion:

Shell respectfully suggests that:

> (i) with respect to the issue of intangible drilling costs (IDC's), the Court has both overlooked a decision of the Oregon Supreme Court which has reversed an Oregon tax court decision on which the Court has relied, and it has misapprehended the effect of the treasury regulation on which the Court has relied; and
>
> (ii) the Court has overlooked an unconstitutional consequence of now holding that the state in this case may tax net revenues derived from Shell's production of oil and gas on the Outer Continental Shelf (OCS).

AS TO IDCS

OMITTED THE TEXT OF THIS TOPIC.

AS TO OSC PRODUCTION INCOME.

For the sake of precise organization of this response, the Department used

Shell's heading which references "production income." But, at the outset, the Department must note its objections to Shell's continued use of an artificially created term "production income," a concept which is a self-created and self-deceiving illusion, which is totally non-existent under federal or state income tax laws. To finally dispense with this illusion, as to the existence of "production income" assume one altered fact situation from that in the Shell record. Assume that while Shell produced all oil on the OCS as evidenced, instead of selling same, Shell merely physically retained possession of the oil as inventory stored anywhere on this earth and did nothing further. It is respectfully submitted that under the federal Internal Revenue Code and under the accounting conventions which underlie any federal tax accounting

BEST AVAILAB

method authorized thereunder, no amount of "income" would be recognized or realized nor would be reportable in the year of extraction. Thus, "production income" is "phantom income" and is nonexistent under the federal code.

The business activities which are nomenclated as "production" are conecedly such that, under federal law, the value of the oil produced which is held in inventory includes the costs attendant to production activities. The business activity which must take place to give rise to any amount of "income" is the activity of making sales. The various states of the United States found their respective ability to tax a respective share of the income arising from such sales upon the fact that such sales are consummated within the jurisdiction of these various states. As this Court correctly decided as to the principal

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issue, the federal preemptive statute operates to restrict the jurisdictional limit of states continguous (sic) to international waters to the 3 mile, not the 10 mile limit.

To compute the income derived from such sales activity, costs incurred in the process of production (extraction on the OCS in the Shell circumstance) are deducted from the sales price to determine the gross profit. Thus, for the determination of the tax base, the cost of production (extraction), not the artificially computed value of the goods measured at the time and place of production (production income) is used to prescribe the offset against the proceeds of any subsequent sale. If Shell's concept of deducting its artifically computed "production income" from the subsequent sales price is followed, its gross profit would be zero or at best

hardly more than the transportation costs which provide subsequent place utility. The expenses attendant to the sales activity are deducted from gross profit. In any event, Shell's "production income" based on "market value" at the wellhead grossly exceeds the "cost of production" else the well would be shut down.

Thus, for income determination purposes, Shell's OCS "production costs" have been fully accommodated. Shell next complains that the same is not true for apportionment purposes.

The precise statement of Shell's second complaint is:

* * * * *

> 2. Based on the "realization" of taxable income at the time refined oil products are sold in the United States, the Court has approved the district court's decision to the effect that the OCS Lands Act does not bar the State of Florida from taxing Shell's OCS production income. In so doing, however, the Court has inadvertently

abridged the constitutional limitations on state income taxation which are set forth in Container Corporation of America v. Franchise Tax Board, 463 U.S. 1659 (1983).

Florida has not taxed all of Shell's net income, including that derived from production activities on the Outer Continental Shelf. But Florida's apportionment formula has not taken into account the payroll or property Shell expended in the course of producing OCS income. Those enormous sums are simply disregarded, as if no money had been used in extracting oil and gas from beneath the sea. See Shell Oil Co. v. Department of Revenue, 9 F.L.W. 769 (Fla. 1st DCA 1984). That is the situation this Court has now approved, and therein lies the problem ....

Shell had urged the first approach by asking the Court to exclude OCS production income from Shell's tax base, but the Court has rejected that portion. The consequence of that rejection is approval of the district court's tax levy on a distorted, and unconstituionally skewed apportionment methodology.

From the foregoing, Shell concedes, arguendo, that while the issue as to the

income determination made addressed by both the district court and by this Court was resolved correctly against Shell, such resolution thereby inadvertently created an unconstitutional distortion as to the corollary apportionment determinations which underly the contested Florida levy.

To provide a proper frame of reference, it is critical to note that in pressing its argument in respect of alleged distortive apportionment fractions, Shell has again shifted gears. It switched from referencing "production income" to referencing what is best nomenclated as "costs of production," such "costs of production" being those incurred on the OCS.

Next, there were two fundamental issues which stem from the initial judicial proceedings which survived to reach possible consideration by the

Florida Supreme Court, namely:

1. Whether this Department improperly included "OCS income" (however defined) in Shell's preapportionment tax base in controvention of a federal preemption, and

2. Whether the Department improperly excluded IDCs from the construction of the property fraction for apportionment purposes.

Based upon a relatively recent decision uttered by the United States Supreme Court, Shell lacks standing at this point to raise the question as to the possible existence of constitutional limitations in respect of the resultant basic apportionment formula, because Shell voluntarily waived and abandoned the apportionment issue (except as to the lesser included exclusion of the IDCs from the construction of the property fraction) early on and repeatedly in the

course of this litigation. Next Shell's insistence that the introduction of "cost of production" into the Florida three-fraction formula is mandated by constitutional provision is absolutely contrary to a recent U.S. Supreme Court decision directly on point.

Further, in response to this issue, Shell has contemporaneously filed a Motion for Order Compelling Compliance with Court Decision under Fla. R. App. P. 9.300. This Motion is a mere extension of its Motion for Rehearing. No separate issues are raised that were not included in the Motion for Rehearing, therefore, the issues that were raised have been responded to in this Response to Motion for Rehearing.

It appears that the sole purpose of the additional motion was to utilize Fla. R. App. P. 9.300 which allows the includsion of "other supporting

documents" an option not available under Fla. R. App. P. 9.330, under which Shell seeks a rehearing. The letters which Shell attempts to place before this Court with its motion are the sole items added by it. A review of these letters shows that the Department has maintained a consistent position and that position is supported by both appellate decisions. The bottom line is that Shell still has no basis to raise this argument.

Shell, by its motion for an order to compel, attempts to raise an embryonic question of fact which it has repeatedly abandoned, that being whether Shell had actually consummated any sales upon the OSC, an issue answered by the Department with a denial. There is nothing in the record before this Court to show that Shell had attempted to perfect or had preserved this factual issue. Quite to the contrary, the district court at page

960 of its decision stated:

> Shell's primary issue is ... whether 43 U.S.C. s. 1333(a)(2)A, infra, prohibits Florida from taxing its income from the sale in the United States of Oil extracted from its outer continental shelf wells. We reject Shell's position that it does, for all of the oil from these wells was brought into the United States, refined in the United States, and then sold in the United States.

Further, in that decision, the district court, at page 961, stated:

> ... the income in Shell's case was realized totally from sales of oil in the various states of the United States.

The Department respectfully submits that this Court, while responding within the frame of reference of the question certified, at page 2 of its decision, stated:

> . . . Accordingly, the dispute concerns only the income derived from sales of OCS oil actually made within the boundaries of the fifty states.

> DOR contends that because Shell sold the oil within the boundaries of the fifty states, and not on the OCS, the taxable event occurred within the reach of Florida's tax laws. On the other hand, Shell contends that the time and location of the actual sale are irrelevant.. . . (e.s.).

It is clear from the existing decisions that the dispute in this case concerns only the income derived from sales of OCS oil actually made within the boundaries of the fifty states.e. (sic)

This observation is further supported by the letters which Shell attached to the motion. The Department calls this Court's attention to the letter dated May 15, 1986, addressed to Shell's counsel, which contains an attachment consisting of extracts of documents filed in an administrative proceeding in Iowa which clearly supports the Department's position that Shell had not consummated any sales of oil on the

OSC and lends additional insight as to the reasons therefore. Lastly, the Department's response to Shell's contentions is contained in the Department's letter response to Shell's counsel dated February 25, 1986, which accompanied Shell's Motion to Compel. Thus, the Department is in full compliance with the decision of this Court.

SHELL'S LACK OF STANDING AS TO THE CONSTITUTIONAL ISSUE.

There is no indication of Shell's objection to the omission from the apportionment factor of "cost of production" visible in either the Final Judgment entered by the trial court nor in the decision of the District Court of Appeals.

To fully compromise its standing as to this issue, Shell, in its initial brief to this Court,, at page 5 stated:

> To avoid confusion on the important "exclusion" (from income) issue, Shell elects not to argue the apportionment issue before the Court. (e.s.)

The utterance in respect of such an election made by the U.S. Supreme Court, completely dispositive of the issue as Shell now claims, arose in the case of another oil company.

The Shell situation compares directly to that Mobile once created for itself (see Mobil Oil Corp. v. Commissioners of Taxes of Vermont), 63 L.Ed.2d 510, 519 (1980). The U.S. Supreme Court noted in that decision that:

> In keeping with its litigation strategy, Appellant has disclaimed any dispute with the accuracy or fairness of Vermont's apportionment formula. See Juris Statement 10, Brief for Appellant II. Instead, it claims that dividends from a "foreign source" by their very nature are not apportionable income. This election to

> attack the tax base rather than the formula substantially narrows the issues before us. In deciding this appeal, we do not consider whether application of Vermont's formula produced a fair attribution of appellant's dividend income to that State. Our inquiry is confined ....
>
> (as) that precludes, as a constitutional matter, state taxation of that income by the apportionment method. Id. at page 519.

The lesser included question of the possible latent constitutional infirmity of the state's chosen apportionment method is waived where the taxpayer voluntarily elects to limit its attack by addressing solely the tax base.

Shell's voluntarily and self-initiated election made before this Court similarly precludes inclusion thereof in any consideration remaining within the question certified to this Court or in those raised on cross appeal, (the latter being limited to construction of a single

specified fraction of the three fraction formula).

However, leaving no stone unturned, the Department now addresses the question of whether the failure to introduce a fourth fraction ("cost of production") or to modify one of the three clearly established fractions ("sales", "payroll" and "property") to reflect "cost of production" precipitates invalidation of the apportionment factor being used due to constitutional considerations. This question has also been answered in the negative by the United States Supreme Court as hereinafter explained.

UDITPA was first promulgated in 1957. Under it, a three fraction apportionment factor was established which consisted of:

1. "sales" (income)
2. "payroll" (expense)
3. "property" (capital employed)

Thus, these three items related to business activities (used in combination) were the measurements deemed by the NCCUSL to adequately achieve what was perceived to be a fair geographic distribution of a share of a given taxpayer's income to each state among the various states.

These are the three specific business activities used in the construction of the Florida apportionment factor. One recognized authority, writing in 1963, included commentary as to "other factors" which had been used in the various states:

> OTHER FACTORS.--A few states employ factors which differ from the standard property, payroll, and sales factors. Wisconsin uses a "cost of manufacturing" factor; other states using the same or a similar factor include Alabama, Kansas, Oklahoma, and Tennessee. Georgia uses a property factor employing the ratio of finished goods

> inventory in the state to total finished goods. Arizona provides for the use of cost of manufacturing and purchases as factors, but in practice they are rarely employed.

Walter H. Beaman, Paying Taxes to Other States, the Ronald Press Co., 1963, at pp. 7-19.

Gradually, over a near term of years, formularly apportionment using the UDITPA three fraction formula emerged as predominant and the use of alternative formulas or fractions faded away. As Justice Powell noted in his dissent in Moorman Manufacturing Co. v. G. D. Blair, 57 L.3d 197, at page 211 (1978), ". . . 44 of the 45 other (than Iowa) States which impose corporate income taxes use a three-factor formula involving property, payroll, and sales ...." Thus, whether by direct adoption of UDITPA or by separate specific amendment as in Wisconsin, use of the "cost of

manufacturing" or the "cost of production" for geographic assignment of income by formularly apportionment is no longer apparent.

Shell now urges that an imperative exists under the constitution which mandates that an additional expense fraction or corollary accommodation be employed in formularly apportionment. The United States Supreme Court expressly disagrees. Again, in Moorman, supra, commencing at page 204, the majority stated, "Yet despite this impression, the (this) Court has refused to impose strict constitutional restraints on a State's selection of a particular formula." In direct contradiction of Shell's construction of a constitutional imperative inherently impacting upon a State's choice of apportionment fractions, the Court sanctioned Iowa's use of its single fraction apportionment

factor - "sales" (income) formula to the total exclusion of all considerations related to either the expense or property. Without question, the total exclusion of the expense nomenclated as "cost of production" from its apportionment factor is an option which Florida has and can exercise with constitutional impunity.

Lastly, Shell cited the recent decision in Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983) as somehow casting favorable light upon Shell's urgings. The Department notes that the Moorman decision focused upon the issue of proper construction of the apportionment formula used to assign the income of a given separate taxpayer. In contrast, the Container decision dealt with the determination of a single tax base for income tax purposes of a group of separate corporations, affiliated by

ownership, scattered worldwide and the relative consequence of the use of the "standard" UDITPA three fraction apportionment formula upon such base determination under the state "unitary" method. That decision actually cited Moorman, repeatedly, supra, with favor and provides little else of consequence here, other than sustaining state use of the "standard" UDITPA three fraction formula, which does not reflect "cost of production" while the income base includes income acknowledgly earned outside the taxing state's jurisdiction.

In Container, California applied the "standard" UDITPA apportionment formula which consisted of:

1. "sales" (income)
2. "payroll" (expense)
3. "property" (capital employed)

Paralleling the basic Florida version of these three UDITPA fractions, California

did not include. directly or indirectly, any reflection of the expense item nomenclated as "cost of production", regardless of where on this earth such costs were incurred (in or out of California's jurisdictional limits measured geographically). The United States Supreme Court by its ultimate conclusion in Container fully sanctioned application of this California apportionment formula (including total omission of the expense known as "cost of production") and that apportionment handling passed constitutional muster.

Shell's attempt to make capital by the use of its perceived latent defect in the Florida result, derived from esoteric analysis of rationale, is totally eviserated by the ultimate Container conclusion.

For the reasons expressed herein, which impeach each of Shell's arguments,

the Department urges this Court to deny all relief requested by Shell.

Respectfully submitted,

JIM SMITH
ATTORNEY GENERAL

Sharon A. Zahner
Assistant Attorney General
Department of Legal Affairs
Tax Section, Capitol Bldg.
Tallahassee, FL 32301
904/487-2412

ATTORNEY FOR RESPONDENT

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Response to Motion for Rehearing has been furnished by U. S. Mail to WILLIAM D. PELTZ, Senior Tax Counsel & ELIZABETH C. BURTON, Tax Attorney, Shell Oil Co., P. O. Box 2463, Houston, TX 77001 and ARTHUR J. ENGLAND, JR., Esq., 2401 Douglas Rd., Miami, FL 33134, this 4th day of June 1986.

Sharon A. Zahner
Assistant Attorney General

COMPOSITE EXHIBIT A OMITTED.

Appendix 14

IN THE SUPREME COURT OF THE

STATE OF FLORIDA

SHELL OIL COMPANY,

Petitioner,

vs. Case Nos. 66,240 and 66,254

DEPARTMENT OF REVENUE,

Respondent.
_____/

Motion for Order Compelling Compliance with Court Decision

Shell Oil Company respectfully requests that the Court order the Department of Revenue to comply with the Court's decision in this case insofar as it excludes from taxation "actual sales consummated on the OCS oil platforms [which] are beyond the reach of Florida's taxing power as limited by section 1333(a)(2)." Shell Oil Co. v. Department of Revenue, 11 F.L.W. at 185 (Fla. April 24, 1986).

1. The Court has held that the amount in controversy between the parties does not include the revenues derived from actual sales of oil and gas which are consummated on OCS oil platforms. This legal determination was predicated on the Department's concession to the Court that there has been no attempt to tax revenue generated from actual sales on the OCS oil platforms. id.

2. The time for requesting rehearing of the Court's decision has expired. Fla. R. App. P. 9.330(a). The Department has not requested rehearing on the Court's confirmation of the Department's concession as to the exclusion of revenue from actual OCS sales.

3. In its computation of the proposed income tax assessment, the Department in fact did not exclude revenues derived from actual OCS sales.

This matter was called to the Department's attention immediately after its concession to the Court during oral argument, but the Department has not corrected its assessment. Attached to this motion are copies of letters exchanged between the parties relative to the Department's position with respect actual OCS sales, which Shell asserts were in the following proportions of OCS production revenue:

1972	1973	1974	1975
17.5%	21.4%	22.5%	19.2%

(See Shell Oil's reply brief at page 8, fn. 5.)

4. Shell can establish that the Department has in fact taxed actual sales on the OCS.

Wherefore, Shell respectfully requests that the Court direct the Department to comply with its concession, and the Court's decision, with respect to

the exclusion of revenues derived from actual sales on the OCS oil platforms in the above proportions. As the Department contests Shell's assertions in this regard, the Court may want to appoint a qualified person to serve as master to conduct an inquiry into the computation dispute and to report his or her findings to the Court.

Respectfully submitted,

William D. Peltz,
Senior Tax Counsel,
-and-
Elizabeth C. Burton,
Tax Attorney
Shell Oil Company
Post Office Box 2463
Houston, Texas 77001
(713) 241-2414

Arthur J. England,
Jr., Esq.
Fine Jacobson
Schwartz Nash Block
& England, P.A.
2401 Douglas Road
Miami, Florida 33134
(305) 446-2200

Certificate of Service

I certify that true and correct copies of this motion were mailed on May 19, 1986 to Joseph C. Mellichamp, III., Esq., Assistant Attorney General, The Capitol, Tallahassee, Florida 32301, and

to Sharon A. Zahner, Assistant General Counsel, Department of Revenue, Carlton Building, Tallahassee, Florida 32301.

BY: _____

May 15, 1986

Arthur England, Esq.
2401 Douglas Road
Coral Gables, FL 33134

RE: Shell Oil Co. v. Dept. of Revenue

Dear Mr. England:

Your letter of April 29, 1986 directed me to have the Department of Revenue revise its present assessment. The audit file does not contain any evidence that there were any sales by Shell Oil to independent third parties on the Outer Continental Shelf. The fact that there have been no sales consummated on the OCS is reinforced by the information contained on the attached page from a brief filed May 8, 1985 by the Department of Revenue in an administrative proceeding in Iowa. In the matter of Shell Oil Company v. Department of Revenue, Docket No. 82-157-2A-A (Iowa Department of Revenue). In

the exchange of correspondence with Elizabeth Burton, to which you make reference, Shell offered no evidence to substanticate its claim.

The letter to Ms. Burton dated February 25, 1986, a copy of which was furnished to you, contains the Department's response in the frame of reference of the case itself.

I would point out a possible legal remedy which you may have overlooked. Chapter 214, Fla. Stat., gives taxpayers one year from the date the tax was paid in which to file for a refund. If your client wishes to present evidence of the existence of sales on the OCS, it would have an opportunity to present it under this Chapter after the tax has been paid.

Sincerely,

JIM SMITH
ATTORNEY GENERAL

Sharon A. Zahner
Assistant Attorney General

SAZ:mr
Attachment
cc: Randy Miller
William Townsend
Ms. Burton

BEFORE THE IOWA DEPARTMENT OF REVENUE
HOOVER STATE OFFICE BUILDING
DES MOINES, IOWA

IN THE MATTER OF	*	
	*	
SHELL OIL COMPANY	*	BRIEF OF
One Shell Plaza	*	DEPARTMENT OF REVENUE
P.O. Box 2463	*	
Houston, Texas	*	
77001	*	
CORPORATE INCOME	*	DOCKET NO.82-157-2A-A
TAX ASSESSMENT	*	

Harry M. Griger
Special Assistant Attorney General
Hoover State Office Building
Des Moines, Iowa 50319
Tel: 515/281-5846

Attorney for Department of Revenue

business of which is the exploration for, and development, production, transportation, purchase, and marketing of oil and chemical products. These activities were engaged in by Shell, an

integrated oil company, and the income of Shell was earned by its unitary business operations. Stip., pars. 2 and 7, Exhibits A through F.

During years 1975 through 1980, Shell conducted the majority of its business activities as two separate operating internal divisions, labeled the Products Organization (Products) and the Exploration and Production Organization (E&P). Stip., par. 3. These internal divisions were functionally integrated in that all of Shell's production of crude oil was transferred by E&P to Products by intra-company transfer, recorded at posted industry prices, but no cash was paid, and the crude oil was either exchanged by Shell with other oil companies or used by Shell to refine or manufacture petroleum or related chemical products. Stip., pars. 3 and 4. Since Shell's production of crude oil was

insufficient to supply Shell's refining and manufacturing needs, Shell had to purchase crude oil from other producers, including purchases from producers on the outer continental shelf and from foreign sources. Stip., par. 4. Also, Shell's entire business activities benefited from an umbrella of centralized management and economies of scale. Stip., par. 7 and Exxon case cited therein.

During 1975-1980, Shell's principal business, within the state of Iowa, consisted of marketing oil and chemical products refined and manufactured by its Products Organization. There

February 25, 1986

Ms. Elizabeth C. Burton
Tax Attorney
Shell Oil Company
P. O. Box 2463
Houston, Texas 77252

Re: Shell Oil Company v. Department of of Revenue
#66,240, #66,254, Florida Supreme Court

Dear Ms. Burton:

Your letter of February 11, 1986 addressed to the Division Director, Division of Audits, Florida Department of Revenue, has been referred to me for response.

Your letter includes the following paragraph:

> "Ms. Zahner's statements are not representative of the treatment accorded Shell in this case. If the Department's position is to remove the income from the sales on the OCS from the tax base then we request it do so, adjust our assessment, and advise the court that the entire assessment is no longer at issue. If the Department's position is to not remove such income, as reflected

> in its 1972 - 1975 audit assessment, then we request that the Department file a notice with the Court that the Department's position was misrepresented by Ms. Zahner in oral argument and specifically correct her misstatements which are more numerous than those specifically set out above."

We respectfully do not agree that Ms. Zahner's cited statements (TR-15 and TR-16) made in oral argument are in any manner misstatements of the Department's position or such position was not applied, to the extent appropriate, in the Shell case. Rather, the conclusion your letter reaches is a misapprehended one founded upon misunderstanding or disregard of the progress of this controversy and litigation, including the underlying facts, as hereinafter explained.

At the outset, the Department's position referred to by Ms. Zahner must be fully stated.

The Department's position is that the net income from a "sale" consummated outside "everywhere" must be subtracted in determining adjusted taxable income for income purposes, and the gross receipts from such sale are similarly to be excluded for apportionment purposes. It is submitted that both determinations must be concurrently made. In effect, "separate accounting" is applied for both net income determination and apportionment determination purposes as both the income being divided and the gross receipts (sales) giving rise to such net income must be synchronized else distortion occurs. However, this position is not applicable where the Department finds no sales have in fact been consummated outside "everywhere." Further, this position is founded solely upon provisions of the Florida Income Tax Code and not upon possible pre-emption

attributable to a federal statute.

Next, there are two fundamental issues which stem from initial judicial proceedings which survived to reach possible consideration by the Florida Supreme Court, namely:

1. Whether this Department improperly included "OCS income" (however defined) in Shell's preapportionment tax base in controvention of a federal enactment, and

2. Whether the Department improperly excluded IDC from construction of the property factor for apportionment.

The balance of this response is limited to discussion of the first issue as stated herein.

In its Amended Complaint filed in the Circuit Court, Shell stated:

> "1. Shell explores for and produces oil and gas, refines same, and markets same (Para. 2).
> 2. Shell markets its products throughout the United States

(para. 4).
3. Part of Shell's net income was earned by its production business (para. 6).
4. Shell excluded income earned from PRODUCTION on the OCS in its Florida income tax returns (Para. 7)."

In its Florida returns for each year, Shell had substracted substantial amounts nomenclated as "Value of Production (OCS)." The Department construed this to be a computation of an amount without the requirement of an actual "sale" transaction. Only marketing requires an actual sale. This concept gave rise to Shell's statement (in its Motion for Summary Judgment) of the issue as:

> "1. The Department's treatment of Shell's income derived from its production business on the Outer Continental Shelf ('OCS') violates the Outer Continental Shelf Lands Act, 43 U.S.C. 1333(a)(2)."

This is the source of the issue now pending decision before the Florida Supreme Court and is generically solely

an issue of law, founded upon contravention of a federal statute.

A potential issue of fact was also present in Shell's Amended Complaint. Paragraph 7 thereof states that consistent with the concept of production income, Shell had excluded "OCS sales" from the denominator of the sales fraction for each year. Further, questions of propriety of such inclusion therein aside, your letter correctly notes that the percentages of sales occurring were ressurrected on page 8 in Shell's Reply Brief to the Supreme Court. Shell had, in fact, filed answers to interrogations in which amounts of sales were claimed to have occurred at the wellhead, expressed as percentages of OCS production, not dollars.

As to the potential issue of fact, the Department's auditor restored amounts of "sales from OCS" (as claimed by Shell)

to the denominator of the sales fraction for each year for the reason that no amount of purported "sales" of tangible personal property were found to have been consummated (as contemplated by Florida law) at the wellhead.

In its Answer and Defenses to Amended Complaint, at Paragraph 6, the Department admits Shell's production activities on the OCS but denies that the earnings were attributable to such OCS production activities, but rather, that the income was attributable to the marketing activities which occurred in the 50 states and the District of Columbia.

Further, in Paragraph 9 of its answer, the Department specifically denied that Shell had substantial OCS sales.

The Department then anticipated a full-blown trial on the merits as to this

potential and clearly controverted factual issue, including an opportunity to cross-examine Shell's witnesses and present testimony of its auditor. Thus, prior to the filing of Shell's Motion for Summary Judgment, the controverted factual issue of whether any "sales" had been consummated on the OCS was clearly evident and clearly in controversy.

Shell chose to waive and abandon this controverted factual issue in its Motion for Summary Judgment by stating that "there is no genuine issue as to any material fact and that Shell is entitled to judgment as a matter of law." This is confirmed by Shell's statement of the legal issue therein as previously noted. Further, Shell's abandonment was wholly consistent with Shell's statement that the "tax may be correctly computed, once Florida and U.S. law are construed in this case..." as so stated in Paragraph

14 of its Amended Complaint. By Shell's act of abandonment of the controverted issue of fact, Shell denied to the Department any opportunity or obligation to prosecute and perfect its defensive position related to the controverted factual issue.

The trial court then denied Shell's Motion for Summary Judgment and found in favor of the Department on the legal issue related to production income. Further, Shell, by its Motion to Amend, withdrew its issue related to alleged improper construction of the denominator of the apportionment fractions by the Department which included "OCS sales." This was done prior to the summary judgment hearing. Logic alone demands that, thereby, Shell confirmed it had abandoned the factual issue related to the existence of "OCS sales" in determination of income.

The amounts labeled "Value of Production (OCS)" subtracted from income by Shell in its returns each year was many times greater than the amounts of claimed "OCS sales" restored to the respective sales fraction denominator by the auditor each year, and hence, cannot represent income attributable to any such "OCS sales." Thus, the dollar amounts underlying the surviving legal issue are not related to Shell's claimed "OCS sales."

The Final Judgment entered by the Trial Court, because Shell withdrew its issue as to apportionment, was by its terms specifically based upon the fact that all surviving issues had been decided on Summary Judgement. Necessarily, that Court thereby recognized and finalized Shell's abondonment (sic) of the controverted issue of fact as to the actuality of any

sales having been consummated on the OCS. Also note that Shell chose to perfect an appeal rather than pursue alternatives available in the Trial Court to reinstate or otherwise resolve the controverted factual issue.

The Appellate Court included references in its decision that "...all of the oil from these wells was brought into the United States, refined in the United States, and then sold in the United States." Further, that court stated that "...the sales...occurred in the various states of the United States defined as 'everywhere', outer continental shelf...do(es) not come within the parameters of 'everywhere,'...". It also stated "...the income in Shell's case was realized totally from sales of oil in the various states of the United States." (Emphasis Supplied) Doubtless, these

statements are at least in part attributable to Shell's decision not to prosecute and resolve the controverted factual issue in the Trial Court.

The Appellate Court, responding to Shell's request, certified a question to the Florida Supreme Court, namely:

> "Whether the State of Florida is Prohibited By 43 USC #1333(a)(2)(A) From Imposing a Tax Upon Income Derived From the Sale in the United States of Oil Extracted From The Outer Continental Shelf?"

This question is the sole question jurisdictionally placed before the Supreme Court which is related to income. It does not admit of any possibility that the controverted factual issue previously abandoned by Shell at the Trial Court is within its purview, except as a lesser included amount of no separate legal consequence.

To further complicate its own case presentation, Shell, in its Initial Brief

at page 5, stated:

> "To avoid confusion on the important "exclusion" issue, Shell elects not to argue the apportionment issue before the Court."

Apportionment being the procedure by which income is geographically assigned, (albeit also used in special circumstances to determine an income subtraction in a "separate accounting" procedure), Shell once again abandoned its claim that any "sales" occurred on the OCS.

Viewing Ms. Zahner's cited statements, particularly in the light of the history of this litigation and the generic nature of the certified question, the statements she uttered were precisely correct and exquisitely appropriate responses within the frame of reference of the question certified to the Supreme Court.

In view of the Department's analysis

as expressed herein, Shell may wish to consider withdrawal of its criticism of Ms. Zahner's statements, and consider including an appropriate apology for its utterance.

Collaterally, Shell, having access to the hearing transcript, may wish to review its oral utterances before the Court to determine the extent to which it adhered to its election expressed in writing to that Court "not to argue the apportionment issue." An edited transcript in which Shell's oral arguments are stated sans all argument related to apportionment would be brief indeed.

In one sense, Shell is in a situation parallel to that Mobil once created for itself (see Mobil Oil Corp. vs. Commissioners of Taxes of Vermont). The U.S. Supreme Court noted in its decision that Mobil, "In keeping with its

litigation strategy...appellant (elected) to attack the tax base rather than the (apportionment) formula" and thereby "substantially narrow(ed) the issues before us."

The Department questions the propriety of inclusion of the reference to the percentage of sales occurring at the wellhead on the OCS in Shell's Reply Brief to the Supreme Court. The certified question is essentially a restatement of the issue addressed in Shell's Motion for Summary Judgment. That question is related solely to the legal issue, the controverted factual issue of sales actually occurring on the OCS having been constructively abandoned by Shell in the Trial Court. As such, evidence related to existence of "OCS sales" is merely evidence in respect of an irrelevancy and has no proper place in the frame of reference of the question

certified. If Shell's case has been damaged by its abandonment of the potential factual issue reflected in the Trial Court record, the wounds are self-inflicted and the responsibility therefore cannot now be visited upon the Department nor the Assistant Attorney General acting as its trial counsel.

The Department notes that Shell's proffered evidence in respect of the irrelevancy was first resurrected in Shell's Reply Brief to the Court well after the Department's opportunity to make written objections thereto had expired under usual procedures as it had previously filed its last brief. If a cry of "Foul!" is to be voiced, it should emanate from the Department's side of the field and not from that of Shell. Inasmuch as the Department's opportunity to do so has been precluded by Shell's timing, does not Shell bear a continuing

burden to point out to the Court the procedural facts related to its reincarnated issue and reconcile same to the Appellate Court's statement that "...the income... was realized totally from sales of oil in the various states of the United States"?

Lastly, your letter concludes that removal of the income arising from the controverted "OCS sales" would reach a result that "the entire assessment is no longer at issue." Even if such removal were conceded arguendo, based upon the auditor's revised reports the allegation that the result renders the entire assessment a nullity is an invalid conclusion. For example, for the year 1972, the auditor restored the $61,478,714 of gross receipts arising from "sales from OCS" which Shell had subtracted to the denominator of the sales fraction. For that year, the

auditor restored to income the amount of $273,532,841 attributable to "Value of Production (OCS)" as excluded by subtraction by Shell in its return for that year. It is submitted that gross receipts of $61 million cannot give rise to $273 million of net income. Rational deduction would conclude that only a minor percentage (derived from overall profit ratios) of $61 million is properly the income attributable to Shell's own self-declared measure of "OCS sales," where Shell has in fact established such sales. If based upon Shell's self-declared "OCS sales," the net income eligible for subtraction under the Department's position would be in the range of 2 percent of the amount excluded by subtraction in Shell's return for 1972. While varying in degree, the same computational dichotomy exists in each of the years at issue.

Necessarily, the instant assessments are founded upon disallowance of the claimed exclusion by subtraction of greater amounts of income derived from production and not upon any substantially lesser included amounts of what Shell now colors as net income derived from controverted "OCS sales". Thus your conclusion as to the nullity of the entire assessment is unquestionably invalid.

Any act of man may be flawed due to human frailty. When the Department discovers that its findings are in error, all appropriate steps are taken to correct its actions. Note that in the Shell case, the Department did exactly that. Upon recognition of an error in its construction of the property fraction, Shell was granted full relief as to that fraction.

However, as to the sales fraction, the Department remains unconvinced that its findings are in error and the Appellate Court appears to have shared such lack of conviction. The Department requires proof by documentation in the form of representative sales invoices with related shipping documents to fix situs of sales. Shell has presented only one self-serving, albeit sworn, statement of conclusion uttered by an employee, untested under cross-examination and totally devoid of documentation. This presentation the Department deems an unacceptable substitute. Lastly, in the Department's view, Shell's moment during which it was ripe to address correction of the construction of the sales fraction has long since passed. The sole question related to income now before the Court is exclusively one of law related to a claimed pre-emption by operation of a

federal statute.

In conclusion, the Department hereby informs you that it will make no effort to notify the Court in respect of the matters contained in your letter. Its further actions will be in response to such other actions as Shell or others may take or to further action by the Court as the Department deems appropriate. However, the Department would have no objection if Shell were to unilaterally initiate appropriate action to correct its presentations to the Court, including action to honor its written elections and choices previously manifested in the progress of this litigation. Lastly, this response is solely the response of the Department and does not in any sense encompass the action, if any, which the Office of the Attorney General may deem appropriate.

Sincerely,

William D. Townsend
General Counsel

CERTIFIED MAIL
RETURN RECEIPT RQUESTED

WDT/FJS/mm

cc: Mr. Arthur England
Fine, Jacobsen, Schwartz,
Nash, Block and England
2401 Douglas Road
Miami, Florida 33134

Ms. Sharon A. Zahner
Assistant Attorney General
The Capitol
Tallahassee, Florida 32301

Joseph C. Mellichamp III, Esq.
Assistant Attorney General
The Capitol
Tallahassee, Florida 32301

Mr. Sam D. Alexander
Director, Division of Audits
Room 617, Fletcher Building
Tallahassee, Florida 32301

March 20, 1986

Mr. William D. Townsend
General Counsel
Department of Revenue
Tallahassee, Florida 32301

RE: SHELL OIL COMPANY V. DEPARTMENT OF REVENUE
#66,240, #66,254 FLORIDA SUPREME COURT

Dear Mr. Townsend:

Your letter rightly focuses on the cause of our dismay with Ms. Zahner's oral argument which is her apparently inadvertent misstatement of fact--her statement that the State of Florida is not herein attempting to tax the income from sales made at the platform. Shell is concerned with the establishment of a wholly consistent position within the Department--either all sales occurring on the OCS are excluded from the tax base or they are not. The auditor did not exclude income from certain platform sales, though Ms. Zahner maintained he

did -- and now the Department is not supporting Ms. Zahner's statement by its refusal to adjust the audit.

As for your assertion that Shell may have abandoned this argument, that is clearly not the case. Shell clearly stated in its first legal document filed -- the Memorandum of Law in support of the Motion for Summary Judgement in the Circuit Court for Leon County, Florida that its "Production Business Income" included actual sales (p. 8). Both the affidavit of the Department's auditor and of J. L. Kennedy referred to "most" marketing. The state's answer recognized that there were some sales at the platform (i.e., on the OCS) though not "substantial sales" in its Answer, s. 9. Thus there was no disagreement regarding fact at the summary judgment stage. The withdrawal of the apportionment issue at

this stage is totally irrelevant, since we are talking only about the composition of the taxable base.

We are, of course, very much concerned with the effect that the misleading statements may have on the Court. One of Shell's arguments was that there was no difference betwwen (sic) actual sales at the OCS wellhead and imputed sales at the OCS wellhead -- and that the realized income in both cases was OCS income and could not be taxed by Florida -- and that the Department's audit of Shell had indeed treated both sales in like manner by including the realized income from both in the taxable base.

However, we await the Supreme Court decision. If it appears that any part of the decision was influenced by Ms. Zahner's statement we will make a Motion

for Clarification. We are, needless to say, disappointed with the position taken in your letter of February 25, 1986.

Sincerely yours,

Elizabeth C. Burton
Tax Attorney

ECB:las

April 29, 1986

Joseph C. Mellichamp, III,
Assistant Attorney General
and
Sharon A. Zahner,
Assistant Attorney General
Department of Legal Affairs
Tax Department
The Capitol
Tallahassee, Florida 32301

Re: Shell Oil Company v.
Department of Revenue

Dear Joe and Sharon:

In accordance with the concession of your counsel during oral argument, the Florida Supreme Court has now held that sales by Shell Oil to independent third parties on the Outer Continental Shelf are excludable from the Florida corporate income tax base. As you know from the recent exchange of correspondence with Elizabeth Burton of Shell, the assessment against Shell at the present time does not reflect this necessary adjustment.

You are hereby directed to revise the present assessment in accordance with

the Supreme Court's directive, and to advise us of the revised assessment immediately. In the event we do not have your revised assessment while the record remains before the Florida Supreme Court, we shall advise the Court of your refusal to comply with their directive and demonstrate our basis therefor.

Sincerely,

Arthur J. England, Jr.

AJEJr./jt

cc: Elizabeth C. Burton, Esq.

February 11, 1986

CERTIFIED MAIL
RETURN RECEIPT REQUESTED
Division Director, Division of Audits
State of Florida
Department of Revenue
Tallahassee, Florida 32301

Gentlemen:

By this letter we are asking for automatic relief from taxes assessed on Shell Oil Company's ("Shell") income derived from sales occurring on the Outer Continental Shelf ("OCS").

Shell Oil Company v. Department of Revenue, # 66,240, # 66,254 was argued before the Supreme Court of Florida on January 7, 1986. Shell claimed that income derived from sales of OCS oil and gas could not be subject to Florida's income tax due to the mandate in the Outer Continental Shelf Lands Act which states that "state taxation laws shall not be applied to the Outer Continental

Shelf." 43 U.S.C. s. 1333(a)(2)(a).

For the years in controversy, (1972-1975) Shell had certain sales of OCS oil and gas production occurring at the wellhead on the OCS. The percentage of sales occurring at the wellhead were enumerated in Defendant's Initial Interrogatories to Plaintiff, No. 29(c) and were incorporated on page 8 in Shell's Reply Brief filed with the Supreme Court of Florida.

Shell did not include the net income from any of its OCS production in the Florida adjusted Federal tax base. The Department's auditor did add-back the net income from all of Shell's OCS production including these sales at the wellhead in determining the Department's assessment. On oral argument, Ms. Zahner, the Department's attorney, stated, "There may

have been some sales out there. There may have been. But there are no sales in this assessment that were out there." (TR-15) The Court continues to pursue this statement, asking how "the ones sold at the wellhead" would appear, would they be taken out. To which Ms. Zahner replies, "They would have to be taken out." And in reply to the Court's question "And you do take those out?" Ms. Zahner says, "Yes." (TR-16)

Ms. Zahner's statements are not representative of the treatment accorded Shell in this case. If the Department's position is to remove the income from the sales on the OCS from the tax base then we request it do so, adjust our assessment, and advise the court that the entire assessment is no longer at issue. If the Department's position is to not remove such income, as reflected in its

1972 - 1975 audit assessment, then we request that the Department file a notice with the Court that the Department's position was misrepresented by Ms. Zahner in oral argument and specifically correct her misstatements which are more numerous than those specifically set out above.

We request that the Department make appropriate notification to the Court within fifteen days of receipt of this letter, and that Shell be advised respecting the Department's action. If we have not been so advised within fifteen days we will take appropriate action.

Sincerely yours,

Elizabeth C. Burton
Tax Attorney

ECB:oa

cc: Mr. Arthur England
Fine Jacobsen Schwartz Nash
Block and England
2401 Douglas Road
Miami, FL 33134

Ms. Sharon Zahner
Assistant General Counsel
Department of Revenue
Carlton Building
Tallahassee, FL 32301

Joseph C. Mellichamp III, Esq.
Assistant Attorney General
The Capitol
Tallahassee, FL 32301

Appendix 15

IN THE SUPREME COURT OF THE STATE OF FLORIDA

SHELL OIL COMPANY,

Petitioner,

vs. CASE NO. 66,240 & 66,254

DEPARTMENT OF REVENUE,
STATE OF FLORIDA,

Respondent. /

MOTION TO STRIKE AND EXPUNGE RECORD

The Respondent, the Department of Revenue, by and through its undersigned attorney and pursuant to Fla.R.App.P. 9.300, respectfully requests that this Court strike the Petitioner's Motion for Order Compelling Compliance with Court Decision and expunge the record of the documents attached thereto. As grounds therefore the Respondent states as follows:

1. The Petitioner has filed a Motion for Order Compelling Compliance with Court Decision. However, the Peti-

tioner has also filed a Motion for Rehearing. Fla.R.App.R. 9.300 makes clear that an Order upon which a Motion for Rehearing is pending, is not final. Therefore, the Petitioner has asked for enforcement based on a non-final order. This Motion for Order Compelling Compliance with Court Decision is wholly inconsistent with the Petitioner's Motion for Rehearing and should therefore be stricken.

2. The Motion for Order Compelling Compliance with Court Decision seeks to absolutely disregard that portion of the decision of this Court which embraces the facts upon which the decision is founded. If Shell believes that this Court has mistaken the facts, then it should so argue in a Motion for Rehearing. Not anywhere in its Motion for Rehearing does Shell complain that this Court has made a mistake as to the facts in this case.

Rather the First District Court of Appeal and this Court have stated, based on the finding of fact in the trial court, that the income in the Petitioner's case was realized totally from sales of oil in the various states of the United States. Shell Oil Co. v. Department of Revenue, 461 So.2d 959, 961 (Fla. 1st DCA 1984) and Shell Oil Co. v. Department of Revenue, Nos. 66,240 and 66,254, at 2 (Fla., April 24, 1986). The Petitioner's Motion for Order Compelling Compliance with Court Decision is an attempt to relitigate facts determined by the trial court and restated in the opinion of the First District Court of Appeal and in this Court's decision. As this Court stated in its decision, "Shell contends that the time and location of the actual sales are irrelevant..." Shell Oil Co. v. Department of Revenue, Nos. 66,240 and 66,254, at 2 (Fla., April 24, 1986).

Petitioner's Motion for Order Compelling Compliance with Court Decision, made post decision, now attempts to reverse its position and make relevant that which was irrelevant at all states of the instant appeal process. Accordingly the Petitioner' Motion for Order Compelling Compliance with Court Decision is an attempt to move this Court to force the Respondent to act in a manner counter to the facts as determined in this case and the position the Petitioner has heretofore taken.

3. Incredibly, the Petitioner has included a document with its Motion for Order Compelling Compliance with Court Decision which should be the basis for rejecting the Motion. The Motion for Order Compelling Compliance with Court Decision introduced an extract from an administrative hearing in Iowa. This extract indicates that Shell has

stipulated for the years at issue in the Iowa controversy that it made no sales on the Outer Continental Shelf. Because there is an overlap of the years in controversy in the Iowa case and the case sub judice, this documents serves as a self executing impeachment of the answer of Interrogatory of number 29 of the Respondent's Initial Interrogatories which is the basis of the Petitioner's Motion for Order Compelling Compliance with the Court Decision.

4. The Respondent asserts that the Motion for Order Compelling Compliance with Court Decision is a disingenuous attempt to introduce facts into the record which could not be introduced in a Rule 9.330 Motion for Rehearing. As noted above, the facts of this case establish that there were no actual sales on the Outer Continental

Shelf which were included in the assessment.

Among the documents submitted with the Petitioner's Motion for Order Compelling Compliance with Court Decision is a letter written by Petitioner's out-of-state counsel of record to one of Respondent's operating division heads. It was not written to Respondent's General Counsel or either of its attorneys of record. In that letter, Petitioner's out-of-state counsel of record alleged, "that the Department's position was misrepresented by Ms. Zahner." This allegation is specious and unfounded.

On February 25, 1986, Petitioner's General Counsel responded to that letter (a copy of which was submitted with Petitioner's Motion for Order Compelling Compliance) and explained to all parties that the allegation was unfounded,

baseless, contained flawed conclusions and was, therefore, totally improper.

Now, in pressing its Motion for Order Compelling Compliance with Court Decision, Petitioner's instate counsel of record has re-stated the original unfounded allegation contained in the original letter. This "ad hominem" attack on an Assistant Attorney General's personal and professional integrity is without merit and contrary to the established facts in the record before the Court.

Respondent's objection respectfully submitted warrants striking the proffered Motion for Order Compelling Compliance with Court Decision. Further, all letters referred to above should be expunged from the Court's files. Granting this Motion to Strike and Expunge Record will prevent futher public review of this matter and limit any

potential damage which inherently arises from re-publication of these unwarranted and unjustified allegations.

5. It appears that the purpose of the Petitioner's Motion for Order Compelling Compliance with the Court Decision is to avoid the restrictions of Fla.R.App.P. 9.330, under which the Petitioner moved for rehearing. No separate legal issues are raised by the Motion to Compel Compliance. Likewise there is no apparent justification for moving separately for such order. Thus, it appears that the purpose of the separate Motion for Order Compelling Compliance with Court Decision is an attempt to use Fla.R.App.R. 9.300 to bring non-record documents before the Court. As stated in the Response to the Motion for Rehearing, the Petitioner's Motion for Order Compelling Compliance with Court Decision appears to be an unauthorized

extention of the Motion for Rehearing. Therefore, the Motion for Order Compelling Compliance with Court Decision should be stricken and the record expunged of the documents attached thereto.

WHEREFORE, the Respondent prays that this Court strike the Motion for Order Compelling Compliance with Court Decision and expunge the record of the documents attached to said Motion because the Motion is unauthorized, redundant, immaterial, impertinent and scandalous. Attorneys fees and the costs in responding to Petitioner's Motion for Order Compelling Compliance with Court Decision should be granted to Respondent.

Respectfully submitted,

JIM SMITH
ATTORNEY GENERAL

JOSEPH C. MELLICHAMP, III
SHARON A ZAHNER
Ass't Attorneys General
Dept. of Legal Affairs
Tax Section, Capitol
Building
Tallahassee, FL 32301
904/487-2142

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U.S. Mail to WILLIAM D. PELTZ, Senior Tax Counsel & ELIZABETH C. BURTON, Tax Attorney, Shell Oil Co., P. O. Box 2463, Houston, TX 77001 and ARTHUR J. ENGLAND, JR., Esq., 2401 Douglas Road, Miami, FL 33134, this 17th day of June 1986.

JOSEPH C. MELLICHAMP
Ass't Attorney General

15-10

Appendix 16

IN THE SUPREME COURT OF FLORIDA

SHELL OIL COMPANY,

Petitioner,

vs. Case Nos. 66,240
66,254

DEPARTMENT OF REVENUE,

Respondent. /

Response to Motion to Strike and Expunge

Shell Oil Company files this response to the Motion to Strike and Expunge filed by the Department of Revenue. The Department has asked the Court to strike Shell's motion of May 19. In that motion, Shell merely requested that the Court order the Department to direct compliance with an unchallenged portion of the Court's decision regarding the computation of Shell's tax liability, if any is ultimately held to be due. The Department's motion should be denied.

1. First and foremost, the Department's motion should be denied because it does not dispute the underlying fact on which Shell's motion rests -- to wit, that the Department has computed Shell's potential income tax liability inaccurately, and inconsistently with this Court's April 24 decision.

The issue at stake here is the exclusion from Shell's income of revenues derived from actual sales of oil and gas on the Outer Continental Shelf. Based on the representation of counsel for the Department, the Court held that such sales are excludable from Shell's taxable income. See 11 F.L.W. at 185.

Shell's motion request only that the Court direct the Department to comply with its representations and the Court's decision. In paragraphs 3 and 4 of the motion, Shell asserts that there were actual sales on the OCS in the years in

question, and that the Department did not exclude them from Shell's taxable income. The Department's rather heated motion to strike does not controvert those assertions. It argues vehemently about various things, all of which are addressed below, but it does not suggest that Shell is wrong in saying that the Department has in fact taxed income from OCS sales.

Shell reasserts that the record in this case in fact demonstrates that the Department's proposed tax assessment included amounts to which the Department is not entitled. Under these circumstances, the Court should deny the Department's request to strike Shell's motion, and the Court should direct the Department to comply with the Court's decision as regards actual sales on the OCS.

2. Shell responds to each of the

numbered paragraphs in the Department's motion as follows.

(a) paragraph 1. The Department states that, because a rehearing has been requested, Shell's motion asks for enforcement of a non-final order and, therefore, should be stricken. The Department is technically correct as to the non-finality of the Court's action. That does not suggest that Shell's motion should be stricken, however. Rather, it suggests that the motion should await the Court's rehearing determination. Shell would concede that its motion will become moot if the Court reconsiders and holds for Shell on the OCS issue. But Shell would have been negligent not to raise the miscomputation of its tax liability, under the Court's decision as announced on April 24, as soon as the matter could have been raised. The earliest opportunity, of course, was when the Court

ruled against Shell on the OCS issue in its April 24 decision.

(b) paragraph 2. The Department next contends that Shell is endeavoring to reargue or relitigate the facts of the case. Nothing could be further from the truth. The facts in the case are those established in the record.[1] Shell knows that those record facts reveal a tax levy roughly 20% in excess of that which the Department concedes, and the Court has held is legally due. Shell is content to rely on the record on this issue. Indeed, Shell has identified the record basis for these facts in its reply

[1] The Department refers the Court to the decision of the district court for the facts. That court's decision is not a substitute for the record as to facts, and in any event nothing in that court's decision says that all OCS revenues were non-sale transfers. Even if the Department believes all revenues were of that type, however, it has led this Court into error, for the Court has stated the contrary based on counsel's representations.

brief. Nowhere in the record, or in its briefs, has the Department contested or controverted these record facts.[2]

(c) paragraph 3. The Department relies on an unsworn, non-record piece of paper, allegedly "an extract from an administrative hearing in Iowa," to prove that Shell made no actual sales on the OCS. This suggestion is truly astonishing. This "extract" was sent by mail to Shell from counsel for the Department following Shell's administrative request to resolve the computation problem. Apparently, the extract was sent to demonstrate that Shell was indeed taxed properly in Florida. The Department's transmittal letter

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[2] The computation dispute is easily resolved by reference to the record. As an alternative, Shell has suggested in its motion that the Court could appoint and permit a special master to examine the record and report to the Court whether the Department has in fact overcharged Shell.

represents that the extract is a page from a brief filed by the Iowa Department of Revenue in an administrative proceeding there. It obviously demonstrates nothing at all relevant to Shell's Florida tax liability.

(d) paragraph 4. Lastly, the Department views an exchange of correspondence which is attached to Shell's motion as a personal attack on counsel for the Department. This concern is wholly unfounded, and regrettable. This correspondence was attached to Shell's motion to demonstrate that Shell had endeavored to resolve the tax computation dispute administratively (which is why Shell's letter was sent to the Department rather than to its attorneys), without involving the Court. The reaction of counsel for the Department to Shell's administrative request, both initially in its letter to Shell and now in its motion

to strike, in unexplainably extreme.

Shell did not intend to and has not impugned the Department's counsel. Shell wrote an operating division of the Department because, as Shell's letter stated, Ms. Zahner's several statements to the Court were "not representative of the treatment accorded Shell in this case" by the Department. Her statements were what they were, and the record is what it is. The two are not consistent. Because the Department has refused to reconcile the inconsistency, Shell was obliged to seek relief from the Court.

Ms. Zahner's integrity is not at issue. Her client, the Department, has put her in an untenable position. Either the Deparmtent had a continuing obligation to conform the actual tax treatment accorded Shell to Ms. Zahner's statements to the Court, or it had an obligation to advise Ms. Zahner that these

statements to the Court were incorrect and allow her to correct them. It has choosen to do neither.

(e) paragraph 5. The Department suggests that Shell's motion ws merely a pretext to circumvent the restrictions of Rule 9.330. That argument is nonsense. Shell does not and did not want this issue reheard. The Court ruled correctly in favor of Shell on the exclusion of actual sales on the OCS. No rehearing is needed.

3. The Department has asked the Court to expunge Shell's motion and attachments. The Department offers no legal basis, statutory or otherwise, to expunge the records in the Court. None exists.

The Department's motion to strike and expunge should be denied. As the Department has not presented the Court with any response to the assertions in Shell's

motion, it should be granted. The Department should be compelled, if Shell ultimately does not prevail on the OCS issue, to comply with the Court's directive. Shell again suggests, however, that if there lingers any doubt as to the Department's mis-computation of OCS tax liability, then the Court should appoint a special master to resolve the factual disagreement between the parties, based on the record in this case, and to report its findings to the Court.

Respectfully submitted,

William D. Peltz,
General Tax Attorney,
-and-
Elizabeth C. Burton,
Tax Attorney
Shell Oil Company
Post Office Box 2463
Houston, Texas 77001
(713)241-2414

Arthur J. England, Jr.,
Esq.
Fine Jacobson Schwartz
Nash Block & England,
P.A.
2401 Douglas Road
Miami, Florida 33134
(305)446-2200
Attorneys for Petitioner

Certificate of Service

I certify that true and correct copies of this motion were mailed on June 25, 1986 to Joseph C. Mellichamp, III., Assistant Attorney General, The Capitol, Tallahassee, Florida 32301, and to Sharon A. Zahner, Assistant General Counsel, Department of Revenue, Carlton Building, Tallahassee, Florida 32301.

By: _____

AJEJr./jt

04382.001